

A guide to the duties and responsibilities of  
the officers and directors of charitable organizations  
doing business in New Hampshire

**VOLUNTEER  
For  
NEW HAMPSHIRE**

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This monograph is dedicated to the many citizens of New Hampshire who give generously of their time and talents to serve on boards of charitable non-profits. We hope this monograph will assist you in understanding your rights and duties as a "member of the board."

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## **BOARD MEMBERSHIP**

By

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The law imposes upon directors and officers of a non-profit organization certain responsibilities (lawyers refer to these as "duties") with respect to the management of the organization and its property. These duties arise as a consequence of the establishment of the organization for a charitable or community purpose rather than for the private profit or enjoyment of its members. An organization established for a charitable or community purpose obtains its property from grants, donations, fund raising activities, charges for the services it offers and investment of the funds it obtains. The donor who makes a \$25 contribution to the poverty organization of which you are a director has the expectation that his contribution will be used by your organization to alleviate poverty in some way. He does not expect that you will simply cash his check and purchase golf balls with the proceeds. Nor does he expect that you will endorse his check and drop it in the collection plate the following Sunday at your church. The donor expects that his contribution will not only be used for a charitable purpose but for the particular charitable activity conducted by your organization.

And courts will enforce the donor's expectation by requiring the organization receiving the contribution to use it exclusively for the charitable purpose of the organization, and for no other purpose. Thus, a charitable organization does not "own" the property it receives in a conventional sense. Rather, it holds that property and may use it only for a specific purpose. This type of arrangement is what lawyers refer to as a "trust" relationship; and where the organization holding the money has a charitable or community purpose it is called a "charitable trust."

Individuals and organizations which hold property given to them for a charitable or community purpose have well-defined duties (called "fiduciary duties") with respect to the property they acquire; and the responsibility for seeing that these duties are carried out rests with the organization's directors and officers. The consequences of violating these duties can be severe for the organization and its individual directors. Civil penalties, investigation costs, court costs and reasonable attorney's fees may be assessed. The director may be responsible for reimbursement to the organization of funds expended for a non-charitable purpose; or for losses of the organization's property due to poor record keeping, mismanagement or imprudent investments. The director may be required to cancel, at personal loss, transactions with the organization which the director had intended would benefit it. The director may even be removed from office, and in extreme cases the organization itself may be dissolved.

Officers and directors can avoid these problems, however, by following a few simple rules. The first is that they actively participate in the affairs of the organization they have been elected to lead. A well run organization has frequent meetings, a diverse and interested governing board, clearly defined committee responsibilities, accurate minutes, well-maintained accessible financial records, expenditure controls, shared, enthusiastic, and open leadership. The second rule is that board members should avoid transactions in which they may personally profit, even though the transaction may also seem to benefit the organization. Not only may such transactions be unlawful, they

invariably result in embarrassment, distrust, adverse comment and lowered levels of effectiveness and community support.

Directors who follow these rules can enjoy their volunteer experiences as officers and directors of non-profit organizations without concern or fear that they will run afoul of the law. Future articles will deal with more technical aspects of director liability, but the cardinal rules will always be: participate actively and limit the benefit you receive from participating to the satisfaction of having served your community well.

## **THE DUTY OF LOYALTY**

By

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The directors, board members or trustees of a non-profit organization have well defined responsibilities called "fiduciary duties" with respect to the management, investment and expenditure of the property and funds received by the organization for its charitable or community purposes. And the most fundamental responsibility the Board member undertakes is to see that the property of the organization is administered solely in the interest of those the organization was established to benefit. This fiduciary responsibility is frequently referred to as the Board member's "duty of loyalty."

The law imposes many different duties on us in our every day lives. We must drive our automobiles carefully so as not to harm our passengers, other motorists or pedestrians. We must keep the entrances to our homes and businesses in good repair and condition so that visitors will not be injured. And when we are paid to repair a car or build a house or give professional advice or treat one who is ill we must perform in accordance with a standard which the law sets. The duty of loyalty in this respect is no different from other duties with which we are more familiar. And, as is the case with the motorist who drives carelessly and injures another, the law will hold responsible the Board member who violates his duty of loyalty to the beneficiaries of the organization he manages.

In other respects the Board member's duty of loyalty differs markedly from other duties more familiar to us. A pedestrian struck by a careless driver is likely to know who injured her and will be able to recover from the driver for her injuries. But the homeless person who is the intended beneficiary of the activities of your poverty organization will rarely be a member of your board or have a representative on it. And it is likely that he will not even be aware of your organization; or if he is, he is not likely to seek you out for help. If, as a Board member, you violate your duty to act solely in the interest of the homeless, neither the homeless or any other person outside your board is likely to become aware of your neglect. Those who make donations to your organization to help the poor are similarly disadvantaged. They, too, are not likely to know how your organization utilizes their donations or whether you are applying the donations for the purpose the donor intended. Thus Board members administer their organization's funds in an environment in which there are very few external constraints and many opportunities for improprieties.

The law has responded by imposing upon directors of non-profit organizations not only a positive duty of loyalty exclusively to the interest of those intended to be benefited but also a number of director SHALL NOT which prohibit the director from obtaining any personal benefit from his

position of trust except in very limited circumstances. These prohibitions on director behavior include:

**(1) PROHIBITIONS AGAINST PURCHASING FROM THE ORGANIZATION.**

Generally a director is prohibited from purchasing or otherwise acquiring property from the organization. Thus the sale to a director of real estate, equipment or other personal property is prohibited. Nor may the director purchase from the organization securities it owns, or mortgages or notes it holds. Transactions in the nature of sales such as loans to directors of the funds of the organization, leases of the organization's property or its hypothecation to a third party as security for a director loan are similarly prohibited.

**(2) PROHIBITIONS AGAINST SELLING TO THE ORGANIZATION.**

Generally, a director is also prohibited from selling to the organization the director manages. A director may not, for example, sell real estate or securities she owns to the non-profit organization on whose board she sits. Nor may a director sell goods or services in which he deals to the charity he manages. In such transactions the non-profit director is serving two masters. He has a self-interest in making a profit from the sale of his services to the board. And he has a fiduciary duty to the beneficiaries of his organization to see that its funds are not wasted or frivolously misspent. Many times it may appear that such transactions benefit both the director and the organization. But in many other cases and especially in significant, major or continuing transactions of this nature the Courts have found that the non-profit director put his personal interests above those of the charity with the result that the charity suffered a substantial loss.

Lawyers refer to these prohibitions on transactions between non-profit director and the organization on which the director sits as the director's "duty not to profit." And while so-called "self-dealing" transactions are often innocent, directors incur substantial risks in them because Courts invariably cancel the transactions and hold the self-dealing director personally liable for any loss suffered by the organization as a result.

To avoid duty of loyalty problems, the best rule a non-profit board can adopt is to prohibit all financial transactions between board members and the organization they represent other than reimbursement for organization-related activities and reasonable compensation for the performance of their duties as directors and officers.

**THE DUTY TO MANAGE**

By

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In previous articles in this series reference was made to the duty of board members to manage the affairs of the charitable organization to which they have been elected as directors or trustees. The duty to manage is a legal duty in the same sense as one's duty to operate a motor vehicle responsibly. In either case the person who does not conduct himself in accordance with the standard established by the law for such activity may be held liable for the harm he has caused. The principle difference: that in the one case it is the injured party who seeks redress; while in the other, because the injury is done to the public interest, it is the Attorney General as the representative of the public who normally seeks redress for the harm.

The concern among board members that they may be held personally liable for some action taken by them in their capacity as the director of a charitable organization is much greater than it need be, however. The Attorney General and the Courts are sensitive to the important role played by volunteers in the management of charitable organizations and it is only in egregious cases that the Courts will hold board members of charitable corporations personally liable for their conduct. By following some commonsense rules board members can enjoy their experience without concern.

### **BEWARE THE ONE MAN SHOW**

If you find after having attended several meetings of the board to which you have been elected, that one or two co-directors exercise a dominant influence over the board and the activities of the organization, do not relax and assume the organization's management is in competent, experienced hands. You have a duty to participate in the management of the organization; and the fastest way to get into trouble is to do nothing. Lawyers call this nonmanagement. Ask to review the minutes, financial records and most recent annual report of the organization. If these are not promptly forthcoming, your best course is to resign.

### **KNOW WHERE THE MONEY GOES**

The funds your organization receives are in the form of donations, grants, dues, income from previous gifts, proceeds from the sale of gifted property, fees for services provided with granted or gifted funds and/or revenues from activities which state law allows charities to conduct to raise funds for charitable purposes. Whatever the source, these funds are held in a fiduciary capacity and must be used only to further the charitable purpose for which your organization was established. Keep track of where the money goes with quarterly written treasurer's reports which detail receipts and expenditures. Adopt an investment policy even for small amounts to require that funds are deposited in federally insured, interest bearing accounts. Larger amounts should be invested only in diversified investment grade securities which can be easily sold on national exchanges, have a history of stability and growth and a good payment record. Have the treasurer prepare periodic statements which detail the name of the account or security in which the funds are invested, its current fair market value and payment record.

Resist the temptation to seek the highest rate of return even though it may produce more income to further the charitable purposes of the organization. The higher the rate of return, the greater the risk. If you retain a stockbrokers or investment advisor, instruct them to invest in accordance with your investment policy.

Above all, never relinquish control of investment and expenditures of funds to an individual who is not a member of the board.

### **RECORDS RECORDS RECORDS**

Records serve several important purposes. But from the perspective of individual director liability their function is to protect board members from the consequences of unauthorized or ill-considered corporate action. If the records of the organization disclose that the action was not board authorized, or that particular directors opposed the action, they cannot later be held liable.

Written minutes must record accurately the votes taken and the names of those in the minority on any question; must be signed, circulated to board members and presented for approval. Fiscal control,

investment, personnel and other policies should be routinely reviewed and updated. Records of federal and state filings, investment records, checking and savings accounts should be readily accessible.

Under no circumstances should members agree to the adoption of resolutions ratifying generally "all actions in the past year."

## **THE DUTY TO REPORT**

By

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This article is designed to explain in detail the duty of non-profit charitable organizations to report to the Attorney General.

NH RSA 7:238, II states: "Except as otherwise provided, every trustee subject to this chapter shall ... file with the attorney general periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration thereof. ..."

We often receive questions from non-profit, charitable organizations about the term "trustee" as used in the statute and whether or not the term should be interpreted to apply not only to trustees but also to officers and directors. The answer to this question is yes. The word "trustee" should be considered a generic term which includes not only trustees, but also officers, directors, and others holding positions of fiduciary responsibility within a charitable, non-profit organization.

Once an organization has registered with the Attorney General it should automatically receive a blank copy of the NHCT-2A annual report form and the annual report certificate. These forms are mailed during the first week of the month following the close of the organization's fiscal year. However, we find many of the envelopes are returned by the post office marked "addressee unknown" or "forwarding order expired." Please be sure to notify the Attorney General of any change of address in a timely manner. If your return is prepared by an accountant you should make sure the forms are turned over to him/her when received by your charity. It is important to use this form since the computer number of the organization is printed on the label and this number allows more efficient tracking of the organization's filing status.

All charitable organizations, regardless of asset size, are required to file a completed financial report with the Attorney General on an annual basis. This report is due four months and fifteen days following the close of the fiscal year. For example, if the fiscal year ends on December 31, 1991, the report is due to be filed on or before May 15, 1992.

If the report will not be completed in a timely manner the organization should apply for an extension of time to file with the Attorney General. The extension request must be in writing and accompanied by the annual \$50 filing fee. Please request the maximum amount of time anticipated to be necessary when asking for the extension.

The Attorney General will accept a variety of forms to satisfy the filing requirements. They are the NHCT-2A mentioned above, IRS form 990, form 990-EZ, or form 990-PF. If an Internal Revenue Service form is filed with the Attorney General it must be fully completed even if the IRS accepts the form in blank. Whichever report is selected by the organization it must be accompanied by a signed and notarized annual report certificate as well as the \$50 filing fee unless the fee was paid with the

extension request. If the organization is incorporated the report must be signed by the President or Treasurer. If unincorporated or if the organization does not have the offices of "president" and "treasurer" then an explanation of the authority vested in the signator must be attached to the report.

The filing itself should represent a complete, fair and accurate report of the organization's financial activity during the reporting period. Keep in mind that the report is signed under oath to be "true, correct and complete" under the penalties of perjury (NH RSA 641:1-3).

The duty to report is an important one and should not be overlooked or taken lightly by charitable organizations. NH RSA 7:28, VI states that "Failure for 2 successive years to file a report shall, unless excused by the attorney general ... constitute a breach of trust and the attorney general shall take such action as may be appropriate to complete compliance." The resignation of the president or treasurer of the organization does not excuse it from the duty to report. The board members should insure that all records are accurate, up-to-date and easily accessible, that regular financial reports are made by the treasurer, and that immediate action is taken if these requirements are not met.

Charitable organizations will soon discover that proper record keeping and the preparation and filing of complete reports will not only meet the requirements of the law, it will also provide a solid financial history from which the board of directors may more accurately plan for the future growth of the charity.

### **THE DIVISION OF CHARITABLE TRUSTS**

The Division of Charitable Trusts is a unit of the Department of Justice, Office of the Attorney General. The statute creating the division was enacted in 1943 and was the first codification in the United States of the Attorney General's common law responsibilities regarding charities. Since 1943 over forty states have enacted similar laws.

The Attorney General through the Director of Charitable Trust exercises all the common law and statutory rights, duties and powers of the attorney general in connection with the supervision, administration, and enforcement of charitable trusts, charitable solicitations, and charitable sales promotions.

The Attorney General is a necessary party to any litigation involving a charitable trusts and represents the public interest in such cases.

The Attorney General also oversees the administration of charitable trusts held in the custody of the State Treasurer, county governments, towns and cities all of which file annual reports with the Division of Charitable Trusts.

The division also prepares and distributes the Directory of Charitable Funds in New Hampshire, a guide to grant-making charities and foundations active in the state. This publication is distributed free of charge to libraries and guidance counselors and is available for a fee to members of the general public.

## **GOVERNOR'S OFFICE ON VOLUNTEERISM**

The Governor's Office on Volunteerism was created in 1983 by Executive Order, and funded by a 5 year grant from ACTION, the federal volunteer agency. The purpose of the Office is to stimulate new active citizen initiatives in the voluntary sector; to promote and support voluntary participation in governmental and local public and private organizations; to provide technical assistance and training to those who deal with volunteers; to gather and communicate information regarding volunteerism. The office currently has a staff of two supported by approximately 200 volunteers. It is funded entirely by contributions, fees, and the Office of the Governor.