**Legal Responsibilities of Nonprofit Boards**

**THE THREE Ds**

The duties of the board of directors of a nonprofit organization can be encapsulated in the three Ds:

duty of care, duty of loyalty and duty of obedience.

Defined by case law, these are the legal standards by which all actions taken by directors are judged. The entire board and individual board members must adhere to these collective duties. Boards demonstrate accountability by showing they have effectively discharged these three duties.

**DUTY OF CARE**

The duty of care requires that directors of a nonprofit organization be reasonably informed about the organization’s activities, participate in decisions, and do so in good faith and with the care of an ordinarily prudent person in similar circumstances. In short, the duty of care requires the board – and individual board members – to pay attention to the organization’s activities and operations.

The duty of care is carried out by:

* Attending board meetings and meetings of appropriate committees
* Preparing in advance for board meetings, such as reviewing reports and the agenda before arriving at the meeting
* Obtaining information, before voting, to make sound decisions
* Exercising independent judgment
* Periodically examining the credentials and performance of those who serve the organization
* Frequently reviewing the organization’s finances and financial policies
* Ensuring compliance with state and federal filing requirements, particularly annual information returns

**DUTY OF LOYALTY**

The duty of loyalty requires board members to exercise their power in the interest of the organization and not in their own interest or the interest of another entity, particularly one with which they have a formal relationship. When acting on behalf of the organization, board members must put the interest of the organization before their personal and professional interests.

In practice, the duty of loyalty is carried out by:

* Adhering to the organization’s conflict-of-interest policy
* Disclosing any conflicts of interest
* Avoiding the use of opportunities for personal gain or benefit
* Maintaining the confidentiality of information about the organization

Conflicts of interest are not inherently illegal – in fact, they are common because board members are affiliated with many different entities in their communities. What’s important is how the board handles them. Conflict-of-interest policies can help protect the organization and board members by establishing a process for disclosure and voting when board members may potentially derive personal or professional benefit from the organization’s activities.

A conflict of interest may occur, for example, when a lawyer serving as a director also provides legal services to the organization. The same may be the case with an accountant, fundraising consultant, or insurance provider. Conflicts can also arise where the organization procures goods or services from a company owned by a board member or a board member’s family.

Even lawful conflicts may draw the criticism of regulators, community watchdogs, and the media. An organization that exhibits too much of this type of behavior may negatively affect the perceptions of prospective donors and otherwise erode its credibility within the community.

**DUTY OF OBEDIENCE**

The duty of obedience requires that directors of a nonprofit organizations comply with applicable federal, state and local laws, adhere to the organization’s bylaws, and remain the guardians of the mission.

The duty of obedience is carried out by:

* Ensuring compliance with all regulatory and reporting requirements, such as filing the annual information return (IRS Form 990) and paying employment taxes
* Examining all documents that govern the organization and its operation, such as bylaws
* Making decisions that fall within the scope of the organization’s mission and governing documents

Generally, directors who carry out their duties faithfully and in adherence to the three Ds will not be found personally liable. Unfortunately, however, there cannot be any guarantees. Remember: Individual responsibility and the responsibility of the board, as a whole, overlap. The demarcation can often be indistinct and, in legal action under certain circumstances, an individual board member may end up paying the penalties or being hit with other sanctions.

Say, for example, an organization fails to pay employment taxes (or taxes that should have been withheld). The organization’s board members (or at least the officers responsible for employment and financial matters) are likely to be expected to personally make the appropriate payment to the IRS. As another example, board members who are directly involved in employment discrimination may be personally liable for damages.

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