

Protecting Against Liability: Internal Controls, Indemnification, and More

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Major Sources of Liability for Foundation Directors and Officers

- Tax and Similar Liabilities
 - Foundation penalties
 - Self-dealing penalties under Section 4941 can be imposed on officers and directors if they engage in a self-dealing transaction with the foundation
 - Foundation manager penalties can be imposed on directors, trustees, officers and key employees as managers for approving or allowing self-dealing (4941), jeopardizing investments (4944), and taxable expenditures (4945)
 - Other liabilities: payroll tax liabilities for a “responsible person” (6672); penalties for failure to provide public inspection of Form 990-PF (6685)

Major Sources of Liability for Foundation Directors and Officers, cont.

- State Law Liabilities

- Fiduciary duties:

- Three fiduciary duties:

- Duty of Care—requires the fiduciaries inform themselves, participate in board decisions, act in good faith, and exercise reasonable care in the oversight of the foundation
 - Duty of Loyalty—requires that fiduciaries put the interests of the foundation above the director's own personal interests or the interests of other organizations
 - Duty of Obedience (sometimes considered as part of the Duty of Care but a separate concept in some states)—requires the fiduciaries to act in accordance with the organization's charitable purpose, Articles, bylaws, and federal and state laws
 - Failure to comply with fiduciary duties may result in removal from position, return of any unjust enrichment, cost of damages to remedy any harm, payment of legal fees

Major Sources of Liability for Foundation Directors and Officers, cont.

- State Law Liabilities

- Related party transactions:

- Many state nonprofit corporations acts include provisions governing related party or conflict of interest transactions
 - Some of these statutes include the imposition of penalties on related parties (such as directors and officers) who engage in related party transactions with a nonprofit corporation if such transactions are not properly approved

Measures to Prevent the Imposition of Liability: Policies

- Adopt, follow, and monitor compliance with appropriate policies
 - Conflict of interest policy
 - Investment policy
 - Whistleblower policy
 - Document retention policy
 - Also consider: grant policy

Measures to Prevent the Imposition of Liability: Board Practices

- All directors should:
 - Familiarize themselves with the articles, mission, bylaws, and other organizational documents
 - Hold and attend regular board meetings
 - Be informed and prepared for board meetings
 - Review all materials and reports
 - Participate in board discussions
 - Inquire and request additional information, where appropriate
 - Exercise reasonable oversight of officers/staff and review performance regularly; participate in setting executive compensation
 - Review and understand financial reports

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