

# 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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