

Non-Profit Revitalization Act of 2013: Corporate and Governance Changes and Implications

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Summary

- Non-Profit Revitalization Act of 2013 (“NPRA”) effective July 1, 2014
- Significant governance changes:
 - Audit committee with “independent directors” required
 - Substantial new “related party transactions” rules (revising existing conflicts rules)
 - Required written conflicts policy and whistleblower policy
 - Electronic action authorized for some governance documents
- Significant transactional changes:
 - Simplified state consents and approvals for mergers, asset transactions, dissolutions, etc.
 - Simplified classification (“charitable” and “non-charitable”) and incorporation
- Significant reporting changes:
 - Charities Bureau review and audit thresholds increased
- Recent developments:
 - Questions emerging from nonprofit community about scope and application of conflicts and audit rules
 - Bills introduced in Legislature to postpone or repeal some changes

I. Audit Changes

- New audit committee:
 - Oversee accounting and financial processes
 - Retain auditor
 - Work with auditor to plan audit
 - Review results of audit and management letter
 - Review auditor independence and performance
 - Review related party transactions (conflicts of interest)
- Composed of at least 3 “independent directors” on committee
- No non-directors on committee

Independent Director Test

- Employment of Director:
 - Not employed by corporation or affiliate (if any) in last 3 fiscal years
 - “affiliate” means entity controlled by or under common control with corporation
 - “Control” not defined
- Other compensation of Director:
 - Not paid >\$10,000 in direct compensation (e.g., as contractor) in any of last 3 fiscal years by corporation or affiliate

Independent Director, cont'd

- Director not “current employee” of (nor have “substantial financial interest” in) an entity that:
 - Received OR was paid lesser of \$25,000 or amount equal to 2% of such entity’s gross revenues in any of last 3 FY’s
- “Substantial financial interest” not defined

Independent Director, cont'd

- “Relatives” of Director also must be checked:
 - Spouse/domestic partner
 - ancestors
 - siblings, grand- and great-grandchildren, and spouses of same
- Test for Relatives:
 - not “Key Employee” of corporation or affiliate in last 3 FY’s
 - Not paid >\$10,000 in direct compensation (e.g., as contractor) within last 3 fiscal years by corporation or affiliate
 - Not a current officer of, and does not have a “substantial financial interest” in, entity referred to in preceding slide

Review/audit reporting changes

- For organizations required to file reviews or audits with Charities Bureau
- Review threshold goes to \$250,000 on July 1
- Audit threshold goes to:
 - \$500,000 on July 1, 2014;
 - \$750,000 on July 1, 2017;
 - \$1,000,000 on July 1, 2021
- Takes effect for filings due after above effective dates, per Charities Bureau guidance
- AG may require audit within 120 days even if nonprofit is below threshold (but above \$250,000)
- Query whether some funders will still require audit even if below above thresholds

II. Related Party Transactions

- “Related Party Transactions” must be approved by board or audit committee
- Independent directors required for approval
- Definition of “Related Party”:
 - Director, officer or “Key Employee” of corporation or affiliate, and Relatives of same
 - “Key employee”: “any person who is in a position to exercise substantial influence over the affairs of the corporation” under IRS rules
 - Can include “substantial contributors”
 - Entity in which any of above persons has 35% or greater “ownership or beneficial interest”

Related Party Transaction: Definition

- “Related Party Transaction”:
 - Any “transaction, agreement or other arrangement”
 - Between corporation or affiliate and any third party
 - In which a Related Party has a “financial interest”
- Omitted in new statute:
 - New rule by its language does not apply to mere overlapping director, officer, or key employee of both corporation and third party *where such person does not have financial interest* in transaction between corporation and third party, unlike current law

Related Party Transaction: Review

- Board or committee of independent directors must review and approve transaction
- Standard: “fair, reasonable and in best interests” of corporation
- If related party has “substantial financial interest,” must also consider “alternative transactions to extent available”
- Document basis for approval
- Related Party must not participate in review process except to provide information
- Note: above is similar to approval process in parallel IRS “excess benefit” rules except for independent director requirement

Related Party Transactions: Consequences

- Attorney General may seek court order to:
 - Account for and repay profits of transaction
 - Void transaction for any violation of statute
 - Recover or repay improper benefits or value of use of property
 - Recover double amount owed if wilful and intentional conduct to obtain improper benefit
- Violation not necessarily just improper benefit. Could include failure to approve transaction.
- Contrast IRS “excess benefit” rules, under which organization can demonstrate transaction is reasonable even if not approved in advance

Related Party Transactions: Action

- *Action Item:*
 - Adopt written Conflict of Interest Policy consistent with statute
 - Familiar element: annual certification for directors
 - Note: Policy will apply to Key Employees as well as directors and officers.
 - After adoption, distribute new policy and collect certifications
- *Action Item:*
 - Identify “Related Parties” and “Related Party Transactions”
 - Review transactions to identify whether subject to new rules
 - Careful application of rules needed re above
 - Collect necessary information and submit transactions to board for ratification

III. Whistleblower Policy

- Widely publicized new requirement
- But policy required only if corporation has \geq 20 employees **and** $>$ \$1,000,000 revenues in preceding FY
- Note: if corporation receives funds from NYS, new “NYS Grants Gateway” has many specific policy requirements
- *Action item*: adopt or revise policy if required.

IV. Electronic action changes

- NPRA permits electronic mail for board (or member) meeting notices and waivers and unanimous written consents
 - Note: e-mail or fax are the only electronic means permitted for same. Thus, for example, DocuSign cannot be used.
 - Member proxies may also be authorized by e-mail
- Arguably this narrows current State Technology Law and federal Electronic Signatures in Global and National Commerce Act
- NPRA also permits video conferencing in addition to telephone conferencing for board or committee meetings
- *Action item*: amend relevant provisions of bylaws to incorporate new requirements

VI. Committee changes

- Relatively minor changes to committees
- “Standing” and “special” distinctions eliminated for board committees
- Majority of entire board must establish board committees (no appointment by President)
- “Committees of the corporation” cannot “bind board”
- *Action item*: add or revise committee provisions

VII. Officer change

- Employee cannot be the board chair (or equivalent office) effective 1/1/2015
- Bill introduced to repeal same
 - Some organizations, such as some churches, have internal requirements that may be inconsistent (e.g., pastor chairing board)
 - Difficult to say chance of success
- Note: this is perceived as a “good governance” issue

VIII. Transaction changes: real estate

- Board vote on real estate simplified.
- Old rule: 2/3 of entire board must approve every mortgage, lease, sale, “other disposition.”
- New rule: majority of entire board unless more than 21 directors or transaction is sale, lease, or other disposition of “all or substantially all” assets

Transaction changes: court and Attorney General approvals

- Transactions: sales of substantially all assets; mergers/consolidations; amendments of purposes; dissolution
- Old rule (in most cases): court approval upon notice to Attorney General
- New rule (in most cases): choice of court approval (upon notice to AG) or Attorney General approval

Transaction changes: agency consents

- In addition to court or AG approval for above transactions, some state agencies required to approve transactions (including incorporations) implicating their jurisdiction
- Education Dept was most commonly required consent
- Simplified now to notice to Educ. Dept. after filing is made

IX. Corporate structure changes: Types

- Old rule: four “Types:
 - Type A: civic, social, trade associations, etc.
 - Type B: corresponds to charitable
 - Other types created confusion and legal issues, e.g., Type C (“lawful business purpose” for “lawful public objective”)
- New rule:
 - Just “charitable” and “non-charitable”
 - Type C language gone
 - Charitable corresponds to current Type B

Corporate structure changes: incorporation

- New rule: permissible to form corporation for any charitable or non-charitable purpose (Senate Bill 6249 signed recently as part of technical amendments to NPRA)
- Also permissible to include statement that no agency consents are required
- Should both simplify and speed up incorporations, put NY in step with other states

X. Other issues

- Lack of guidance from Charities Bureau on governance and transaction changes
 - Bureau reportedly working on guidance
- Whether legislature will revisit independent directors, related party transactions, and other governance changes
 - Trade groups are raising issues with new law
 - Bills introduced to delay or repeal some changes
- Significant proposals not adopted:
 - Clause protecting directors from monetary liability for non-intentional fiduciary duty breaches
 - long permitted for NY business corporations and business and nonprofit corps in other states
 - Elimination of agency consent process (defer to regulatory laws instead)