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Significant changes to New York not-for-profit laws take effect July 1

The Nonprofit Revitalization Act of 2013 makes substantial changes to long-standing laws that have governed not-for-profit organizations operating in the state. The law seeks to ease administrative burdens on not-for-profits while strengthening governance and financial oversight requirements. Key reforms include new conflict-of-interest and whistleblower protections and a streamlined approval process for corporate transactions. Not-for-profit organizations and their trustees will want to make all changes necessary to ensure compliance when most of the new law's provisions take effect on July 1, 2014.

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Background

The Nonprofit Revitalization Act of 2013 (Act), enacted on December 18, 2013, made the first significant changes to the state's Not-for-Profit Corporation Law (N-PCL) in more than 40 years. It includes reforms that reduce administrative burdens on not-for-profits while enhancing their governance and oversight. The Act affects not-for-profit organizations incorporated or doing business in New York, including charitable and non-charitable entities.

Governance

The Act requires all not-for-profits to adopt conflict of interest policies and larger organizations to put whistleblower policies in place. In addition to tightening the related party transaction rules, the Act imposes new measures to ensure board independence and restrict the ability of interested parties to set their own compensation. It also simplifies board operations by permitting email notices and consents, and streamlines procedures for major corporate actions such as mergers or dissolutions.

All not-for-profits must adopt conflict of interest policies, and those with at least 20 employees and more than $1 million in annual revenue must put whistleblower policies in place.

Conflict of interest

The Act requires not-for-profits and charitable trusts to adopt a conflict of interest policy that requires their directors, officers, trustees, and key employees to act in the best interest of the entity. In addition to defining what constitutes a conflict, the policy must contain specific procedures for disclosing a conflict to the audit committee or board of directors. Among other things, the policy must:

- Prohibit conflicted persons from participating in board, trustee, committee meetings, or votes on the matter giving rise to the conflict, or attempting to influence their votes
- Require documentation in the organization's records of the conflict and its resolution
- Require directors and trustees to disclose potential conflicts before their initial election or appointment, and annually thereafter

  Buck comment. Existing policies should be updated to reflect the changes to the conflict of interest rules. These changes apply to all not-for-profit organizations, regardless of size.

Whistleblowers

The Act requires not-for-profits with at least 20 employees and annual revenue in excess of $1 million in the prior fiscal year to adopt a whistleblower policy. The policy must provide procedures for reporting alleged violations and related confidentiality protections, and prohibit retaliation — or, in the case of employees, adverse employment actions — against a director, trustee, officer, employee, or volunteer who reports an action or suspected action by or within the organization that he believes in good faith to be illegal, fraudulent, or violates company policy. Among the specific provisions that must be included are:

- Designation of a director, trustee, officer, or employee to administer the policy and report to the audit committee, trustee committee, or the board
- Required distribution of the policy to all directors, officers, employees, and volunteers who provide substantial services to the organization

  Buck comment. An organization will be deemed in compliance if it has adopted a whistleblower policy under federal, state, or local laws that is substantially consistent with the new requirements.

Related party transactions

The Act tightens the related party transaction rules, putting in place new rules against self-dealing. The Act prohibits a covered organization from entering into a transaction, agreement, or other arrangement in which a related party has a financial interest unless the board determines that the transaction is fair, reasonable, and in the organization's best interest.

Directors (or trustees of a charitable trust), officers, and key employees must disclose the material facts of any such interest to the board or to an authorized committee of the board, and the board may adopt additional restrictions and procedures in its governing documents or policies. Interested parties may not participate or vote on the transaction, but they may be asked to provide information at a board or committee meeting prior to a vote. If a related party's financial interest in the transaction is substantial, the board or authorized committee of the board must:

- Consider available alternatives

- Approve the transaction by a majority of the directors or committee members at the meeting
- Contemporaneously document the approval as well as the consideration of alternatives

Incorporation documents and by-laws

Because various provisions of the Act were intended to simplify board operations, not-for-profits will want to review their incorporation documents and, as needed, revise existing by-laws to reflect new corporate classifications and board procedures.

Corporate classifications. The Act reduces the types of nonprofit corporations from the current four (Types A, B, C, and D) to two, and reclassifies nonprofits as either “charitable” or “non-charitable.” Type B and C corporations along with Type D corporations formed for a charitable purpose will automatically become charitable corporations, while Type A and all other Type D corporations will become non-charitable corporations.

> Buck comment. Although corporations formed prior to July 1, 2014 will not be required to refile, their current by-laws should be updated to reflect the change.

Board of directors. To simplify board operations, the Act will allow board members to participate in meetings by video conference (such as Skype) unless prohibited by the corporation’s certificate of incorporation or by-laws. Notice of board and member meetings, waivers of notice, proxy designations for members, and actions by unanimous consent may also be made electronically. Amended by-laws may include fax and email as accepted means of communications.

To ensure board independence, the Act prohibits an employee from holding the position of chairman of the board, and by-laws should reflect that change effective January 1, 2015. To prevent interested parties from approving their own compensation, the Act prohibits any member, director, or officer from being present at or participating in any board meeting concerning his or her compensation from the not-for-profit. However, the board or a committee of the board may ask an individual who may benefit from the compensation to provide information or answer questions at a meeting prior to its deliberations or voting. Applicable procedures may be provided in the by-laws.

Streamlined corporate transactions

The Act simplifies the current state approval process by allowing nonprofit organizations to incorporate, dissolve, and merge more easily, and to enter into transactions without having to go to court. The Act gives the state attorney general discretion to grant certain approvals, such as a change in the charitable corporation’s purpose, a merger, or the dissolution and distribution of a corporation’s assets.

The Act also simplifies the approval process for the purchase, sale, mortgage, or lease of real property by eliminating the N-PCL’s current requirement that all real estate transactions be approved by two-thirds of the entire board of directors (including vacant seats). Unless the transaction involves all or most of the organization’s assets, the transaction generally may be authorized by a simple majority vote of the entire board or of a committee authorized by the board.

Financial oversight

The New York Executive Law requires charities that solicit funds in New York state and entities that administer funds for charitable purposes to register with the Charities Bureau of the Office of the Attorney General and to submit annual financial reports to that office. Whether audits have to be certified depends on the entity's gross revenue. The Act eases the current reporting requirements.

Audits and financial reporting

Effective January 1, 2015, organizations that are required to register for charitable solicitation will be required to have a designated audit committee of the board comprised of independent directors or the independent directors on the board must perform the duties of an audit committee if they:

- Have gross revenues of more than $500,000 annually
- Are required to file an independent auditor's report with the state attorney general

Either the audit committee or the full board must oversee the organization's accounting and financial reporting process and the audit of its financial statements, retain an independent auditor, and review the audit results. For organizations that have annual gross revenues of more than $1 million, the board or the audit committee must hold pre- and post-audit conferences with the auditors.

To reduce current burdens on not-for-profits, the Act raises the revenue threshold for filing audited financial statements with the state attorney general's office. Beginning July 1, 2014, certified audits will be required for organizations with more than $500,000 in revenue and support, up from the current $250,000. The threshold will increase to $750,000 in 2017, and $1 million in 2021. Smaller organizations will not have to file audited financial statements. Guidance issued by the Charities Bureau confirms the new filing thresholds for annual financial reports with an original or extended filing due date on or after July 1, 2014. Requirements for annual reports with a filing due date before July 1, 2014 are unchanged.

In closing

Not-for-profit organizations will need to update their policies and corporate documents to comply with the changes to the N-PCL, many of which take effect on July 1, 2014. They are likely to face particular compliance challenges as they address the new requirements dealing with related party transactions, audit committees, and whistleblowers. Now that New York has taken steps to increase not-for-profits' transparency and responsibility, it remains to be seen whether other states will follow suit.

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