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Nonprofit ALERT

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THE NONPROFITS REVITALIZATION ACT OF 2013 REQUIRES MANY CHANGES FOR NEW YORK NONPROFIT ORGANIZATIONS

OVERVIEW

The Nonprofits Revitalization Act of 2013, signed into law by Governor Andrew Cuomo on December 18, 2013, makes significant changes to the New York Not-for-Profit Corporation Law (the "NPCL") and the Estates, Powers and Trust Law (the "EPTL"). Most of the Revitalization Act's provisions go into effect on July 1, 2014.

The Revitalization Act is intended to ease burdens faced by New York-formed nonprofits, especially smaller organizations. The Act increases thresholds for state-mandated audits, relaxes the approval process for major transactions, and permits email notices and consents. At the same time, the Act imposes new and stricter governance requirements, tightening procedures for approving related-party transactions, requiring all nonprofits to have conflict of interest policies, and requiring larger organizations to put whistleblower policies into effect.

Most New York nonprofits need to take certain steps before the Act goes into effect to remain in compliance with the law. Many will have to amend their bylaws and governance policies, and many should consider taking advantage of the changes that reduce reporting and other costs. This Kramer Levin Practice Alert is devoted to explaining changes wrought by the Nonprofits Revitalization Act of 2013, looking first at revisions that can ease administrative burdens on nonprofits, and second at revisions that require enhanced governance policies. The third section of this alert lists actions that all New York-formed nonprofit organizations should take before July 1, 2014.

CHANGES THAT REDUCE BURDENS

The Revitalization Act eases the administrative burdens on nonprofits in several ways. For example, it raises the revenue threshold above which organizations must file audited financial statements with the New York State Office of the Attorney General. It simplifies the state approval process for major corporate actions such as merging with another nonprofit or dissolving the corporation. This section discusses changes that lighten the administrative costs of running a nonprofit organization.

Two Types of Nonprofit Corporations – Not Four

The current law classifies nonprofit corporations as Type A, Type B, Type C, or Type D.[i] The Revitalization Act takes a simpler approach: nonprofits are either charitable or non-charitable. The Act grandfathers in nonprofits formed before July 1, 2014 – they will not be required to file any new paperwork.

Reporting Burdens Eased

New York State requires all charities soliciting funds in New York State, and all entities administering assets for charitable purposes, to register with the Charities Bureau of the Office of the Attorney General and to file an annual report giving financial information.

The Revitalization Act raises revenue thresholds for filing audited financial statements. Currently, nonprofits with annual gross incomes of $250,000 or more must file an audited financial report prepared by an independent certified public accountant. The Revitalization Act raises this threshold from $250,000 to $500,000 on July 1, 2014 (with later threshold increases to $750,000 in 2017 and $1 million in 2021). Nonprofits with annual gross revenues of $100,000 to $250,000, which currently must file financial statements that have been reviewed by an independent certified public accountant, will be able to file their statements without independent review.

The Revitalization Act also eliminates provisions requiring all nonprofits using paid fundraisers, whatever the nonprofit's revenues, to file audited financial statements. Thus, as a result of the Revitalization Act many nonprofits will be able for the first time to file financial statements without review or audit by an independent certified public accountant.

Simple Majority to Authorize Real Estate Transactions

The NCPL currently requires that all real estate transactions – purchases, sales, mortgages, leases – no matter the size, be approved by a two-thirds vote of the entire board of directors. The term "entire board" includes vacant seats.

The Revitalization Act permits boards to approve real estate transactions by a majority vote of the entire board or by a majority vote of a committee authorized by the board; provided, however, that if the transaction involves all or substantially all of the assets of the corporation, then a vote of two-thirds of the entire board is required (or by a majority if there are twenty-one or more directors).

Simplified Procedure for Major Corporate Actions

Under the Revitalization Act, corporations will be able to go through a one-step approval process (approval by the Charities Bureau of the Attorney General's Office) instead of the more cumbersome and costly two-step process (court approval following review by the Charities Bureau) required for major corporate actions including:

- dispositions of all or substantially all corporate assets;
- amendments to purposes or powers in the articles of incorporation;
- mergers and consolidations; and
- dissolutions.

Simplified Board and Member Operations

The Revitalization Act permits nonprofits to issue notices of member meetings by fax and email, and allows members and directors to waive notice requirements the same way. Directors may attend and participate in board meetings by video screen. If their bylaws permit them to authorize action without a meeting by giving written consent, directors may give consent by email. (Whether in writing or by email, consent without a meeting must be unanimous.)

More Flexibility in Setting the Number of Board Members

The definition of the term "entire board" is amended to accommodate new authority granted by the law to nonprofits to set the board's size without amending bylaws. Specifically, nonprofit corporations without members may set the board's size from time to time without amending the bylaws. (This is already permitted for membership corporations.) They may either set the exact number of directors in their bylaws, or include a provision in the bylaws granting directors authority to set the number of directors from time to time, or specify a range in the bylaws for the number of directors (in which case, "entire board" means the number within that range elected or remaining on the board at the most recent election).

Simplified Committee Structure

The Revitalization Act eliminates the distinction between "standing" and "special" committees: all board committees will be "standing" committees. Under the current law, standing committees may have all the authority of the board, must consist of no fewer than three members and are appointed by a majority vote of the entire board. In contrast, special committees have only those powers specifically delegated to them by the board, may have fewer than three members and, if there is no procedure set forth for their appointment in the bylaws, are appointed by the chair of the board. All the committees under the Revitalization Act have the powers of standing committees, however, the new law also requires, if indirectly, that all committees be appointed by a majority of the entire board and have at least three members.

Grant Writers Are Exempt from Rules Governing Fundraisers

New York State requires fundraising professionals to register annually with the Attorney General's Charities Bureau. Nonprofits, in turn, must have written contracts with any fundraising professionals they engage and those contracts must contain specific anti-fraud provisions. The fundraising professionals must file the contracts with the Charities Bureau within ten days of being signed, and before any soliciting can begin, nonprofits must obtain written confirmation from the fundraising professionals that they are in full compliance with the registration and filing requirements of the law. The Attorney General had considered individuals hired solely as grant writers to be fundraising professionals, subject to the requirements of the law. The Revitalization Act specifically exempts individuals hired solely to draft grant applications to governmental agencies and philanthropic organizations recognized as tax-exempt under Section 501(c)(3) of the federal tax code.

CHANGES STRENGTHENING GOVERNANCE PRACTICES

Related-Party Transactions: New Rules Against Self-Dealing

The Revitalization Act replaces a presumption in the law in favor of the enforceability of a related-party transaction with a presumption that these transactions are barred unless nonprofits follow procedures requiring nonprofit boards to subject such transactions to careful scrutiny.

All directors (or trustees in the case of a charitable trust), officers and key employees who have an interest in a transaction must disclose the material facts of the interest to the board of the organization. Interested parties may not participate in deliberations or votes on the transaction. And the directors or trustees may not enter into the transaction unless they have determined that the transaction is fair, reasonable, and in the best interest of the nonprofit.

If a related-party transaction involves a charitable organization and the related party has a substantial financial interest in the transaction, the board (or an authorized committee) must consider alternative transactions, to the extent available; approve the transaction by not less than a majority of the directors or trustees (or committee members) present; and contemporaneously document the basis for approval, including the alternative transactions considered.

The Revitalization Act empowers the Attorney General's Office to take action to enforce these provisions and to impose steep penalties. The Attorney General is given new powers to bring a lawsuit to enjoin, void or rescind any related-party transaction that violates any of these provisions (or that is otherwise not reasonable or in the best interest of the nonprofit at the time the transaction was approved), to obtain restitution, and to remove officers and directors. The penalty for willful or intentional conduct is an amount up to double any benefit improperly obtained.

Conflict of Interests Policies

The Revitalization Act requires all nonprofit corporations and charitable trusts to adopt a written conflict of interests policy. The law requires that the policy contain these provisions:

- a definition of the circumstances that constitute a conflict of interest;
- procedures for disclosing a conflict to the audit committee or the board;
- a requirement that a person with a conflict not be present at or participate in board or committee deliberations or vote on the matter creating conflict;
- a prohibition against any attempt by a person with a conflict to improperly influence the deliberation or vote;
- a requirement that the existence and resolution of a conflict be documented in the organization's records, including in the minutes of any meeting where the conflict was discussed; and
- procedures for disclosing, addressing, and documenting related-party transactions.

Also, the Revitalization Act adds a requirement to the law that before a director is elected to a board of a nonprofit corporation, and annually thereafter, the director must submit a signed statement to the board secretary identifying all of the entities of which the director is an officer, director, trustee, member, owner or employee, and any transaction in which the corporation and director might have a conflict of interest.

Whistleblower Policies

Every nonprofit organization with 20 or more employees and annual revenues in excess of $1 million must have a whistleblower policy, under the Revitalization Act. The policy must contain several components including a provision that there will be no retaliation, intimidation or other adverse employment action against a volunteer, employee, officer, director or trustee who in good faith reports an action, or suspected action, by or within the organization that is illegal, fraudulent, or in violation of the organization's adopted policies.

The whistleblower policy must also contain:

- procedures for reporting violations and for preserving the confidentiality of reported information;
- a requirement that an employee, officer, or director or trustee be designated to administer the policy and to report to the audit committee or other committee of independent directors, or, if there is no such committee, to the board; and
- a requirement that a copy of the policy be distributed to all directors, trustees, officers, employees and volunteers.

New Audit Oversight Requirements

The legislature has added provisions to the law intended to insure that the directors and trustees of nonprofits are aware of and respond to risks identified by auditors. The Revitalization Act adds the term "independent director" to the definitions sections of the NPCL and the EPTL,[ii] and imposes on the board, or a designated audit committee consisting solely of independent directors, an obligation to oversee the accounting and reporting process of the nonprofit and the audit of financial statements.

The board, or its designated audit committee, must annually retain or renew the retention of an independent auditor to conduct an independent audit, and must review the results, including any management letters that accompany the audit, with the auditor.

What's more, the directors (or trustees) of all nonprofits with annual gross revenues in excess of $1 million have additional duties. The board, or a designated audit committee (comprised solely of independent directors), must:

- review the scope and planning of the audit with the independent auditor before the audit;
- review and discuss with the independent auditor any material risks and weaknesses in internal controls identified by the auditor, any restrictions on the scope of the auditor's activities or access to requested information, any significant disagreements between the auditor and management, and the adequacy of the corporation's accounting and financial reporting processes; and
- consider the performance and independence of the independent auditor annually.

Only independent directors may participate in board deliberations or votes concerning the above requirements.

Board Chair

The Revitalization Act adds a provision prohibiting any employee of a nonprofit corporation from serving as board chair, effective January 1, 2015.

Executive Compensation

The Revitalization Act amends the law with respect to executive compensation: No person who may benefit from executive compensation may be present at or otherwise participate in any board or committee deliberation or vote concerning that person's compensation.

GET READY FOR THE NEW LAW

New York nonprofits should take these steps before July 1, 2014:

STEP 1. Review your bylaws and amend them as necessary to comply with the new provisions of the law. In particular, be sure they:

- contain the proper procedures for approving related-party transactions;
- preclude any employee from serving as chair of the board;
- eliminate "special" and "standing" board committees.

STEP 2. Review your conflicts policy and amend it to comply with the new provisions of the law. If you do not have a conflicts policy adopt one.

STEP 3. Determine whether you need a whistleblower policy. If you have an annual revenue of more than $1 million and twenty or more employees, you need to establish one.

STEP 4. Review your audit procedures. If you are required to file audited financial statements with the Charities Bureau you need an independent audit committee or independent directors or trustees to supervise and review the process.

STEP 5. Identify the directors or trustees that satisfy the requirement of independence and determine whether you have a sufficient number to populate an audit committee (there must be at least three independent members), or to constitute quorum of the board should the board perform the audit function.

STEP 6. Consider likely related-party transactions and determine whether you have a sufficient number of disinterested board members to approve related-party transactions. There must be a sufficient number to constitute a quorum of the board.

STEP 7. Consider amending your bylaws to permit the board to change its size from time to time or to set its size within a given range.

STEP 8. Consider amending your bylaws to track the new provisions concerning real estate transactions.

STEP 9. Consider amending your bylaws to lower the quorum requirements to be as low as the law allows so that independent and disinterested members can constitute a quorum.

STEP 10. Consider amending your bylaws to permit member and director action by electronic consent

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[i] The current classification system: Type A = a nonprofit formed for civic, patriotic, political, social, fraternal, athletic, agricultural, or horticultural purposes, and professional, commercial, industrial, trade or service association. Type B = a nonprofit formed for charitable, educational, religious, scientific, literary, or cultural purposes or for the prevention of cruelty to children or animals. Type C = a nonprofit formed for any lawful business purpose to achieve a lawful public or quasi-public objective. Type D = a nonprofit formed under any other corporate law of the state for purposes within Types A, B, or C.

[ii] Nonprofit Revitalization Act § 29, creating NPCL§ 102(21); Nonprofit Revitalization Act § 130, creating EPTL§ 8-1.9. An independent director or trustee is a person "who (i) is not, and has not been within the last three years, an employee of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within three years, an employee of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than $10,000 in direct compensation from the corporation (other than for reasonable compensation for service as a director) and (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has made payments to, or received payments from, the corporation or an affiliate of the corporation for property or services worth the lesser of $25,000 or two percent of the entity's gross revenues."