June 20, 2014

Changes to New York Nonprofit Governance Law Effective July 1, 2014

On July 1, 2014, certain substantial changes to New York nonprofit law will take effect, and will require compliance by all nonprofit organizations incorporated in New York, as well as certain nonprofit organizations doing business or soliciting donations in New York even if incorporated elsewhere.

The New York Nonprofit Revitalization Act of 2013 (the "Act") represents the most significant update to New York's nonprofit laws in 40 years, and is intended to enhance nonprofit governance and oversight to prevent fraud and improve public trust, as well as to reduce unnecessary and outdated burdens on nonprofit organizations. As summarized in this memorandum, the Act requires all nonprofit organizations to review existing governing documents, policies and internal controls.

Actions Required by July 1, 2014

The following summary outlines the steps all New York nonprofit organizations (and, where indicated, certain nonprofits incorporated elsewhere) should take to ensure compliance as of July 1, 2014:

- *Adoption or Amendment of Conflicts of Interest Policy*. Every nonprofit organization incorporated in New York must have in place as of July 1, 2014 a Conflicts of Interest Policy including, at a minimum: a definition of conflict of interest; conflict disclosure procedures for board or committee oversight; a prohibition on conflicted parties influencing deliberation or voting on the matter presenting the conflict; and procedures for addressing, documenting, and disclosing related party transactions.

  The Act provides that organizations that have adopted a Conflicts of Interest Policy as required by federal, state or local law that is substantially consistent with the Act's requirements will be deemed in compliance with the Act. Note, however, that even existing policies based on the IRS sample should be reviewed for compliance with the Act.

- *Related Party Transactions; Compensation*. In addition to the above, other substantive provisions of the Act relate to conflicts of interest and fairness in compensation practices. To ensure compliance, it is best practice to include in your organization's Conflicts of Interest Policy, by-laws or appropriate committee charter the following: a definition of "related party transaction"; procedures for disclosure of interests by directors, officers, or key employees; and, mechanics for scrutinizing a proposed related party transaction. With respect to compensation paid to members, directors, or officers, no person who may benefit from a given compensation policy may be present at, or participate in, deliberation and voting with respect to such compensation.

- Prohibition of Employees Serving as Board Chair. Effective as of January 1, 2015, the Act will bar any employee of the organization from serving as chair of the board or holding a title with similar responsibilities.

- *Adoption or Amendment of Whistleblower Policy*. Nonprofit organizations incorporated in New York, having 20 or more employees and annual revenue of at least $1 million (as measured by the prior fiscal year), must adopt a whistleblower policy or amend any existing policy to comply with the requirements listed below. The whistleblower policy must include the following: procedures for reporting violations or suspected violations of laws or corporate policies; designation of an employee, officer, or director to administer the policy; and, distribution of the policy to directors, officers and employees as well as volunteers who provide substantial services to the organization.

- *Review and Amendment of By-laws*. The Act eliminates the distinction between "standing" and "special" committees of the board. Instead, all board committees will be standing committees, to which the board may delegate all or part of its authority, and on which only voting members of the board may serve. Committees of the corporation, on which non-board members may serve, may not be delegated any board powers, or the authority to bind the board. All references to "special committees" should be removed from by-laws, such that the only permitted committees are standing committees of the board and committees of the corporation.

- *Audit Oversight Requirements*. Under both current law and the Act, organizations that have a certain minimum amount of revenue generated in New York and are registered to solicit contributions from the public are required to file audited financial statements with the New York Attorney General, whether incorporated in New York or elsewhere (such requirements generally will not apply to private foundations). The Act introduces specific oversight functions for the financial audit which must be performed by independent directors of the board or a committee comprised solely of independent directors. These functions include retention of an independent auditor, oversight of the implementation of the audit, and oversight of the conflict of interest and whistleblower policies (subject to certain exceptions if the latter function is performed by an independent committee of the board).

  If an organization expects to have annual revenue over $1 million, the board or audit committee must also review the procedures of the audit prior to its execution and review and discuss the audit with the independent auditor upon its completion, including risks and weaknesses in internal controls, restrictions on the auditor's activities or access, disagreements between the auditor and management, and the adequacy of accounting and financial reporting processes. If an audit committee performs the audit function, it must report its activities to the board.

  We recommend that the above requirements be reflected in the by-laws or audit committee charter.

Additional Provisions of the Act Reducing Certain Governance Requirements

- Elimination of Type Classification. Under the Act, the "Type" classification system designating nonprofits as "Type A," "Type B," "Type C" or "Type D" corporations has been eliminated. In its place, nonprofit organizations will be classified only as "charitable" or "non-charitable" corporations. Existing organizations do not need to take any action to reflect this automatic change. Most 501(c)(3) organizations will be reclassified as "charitable corporations."

- Increased Revenue Thresholds for Audit Requirement. Currently, organizations with annual revenue in excess of $250,000 must submit audited financial statements to the New York Attorney General along with their annual reports. The Act will raise this minimum revenue threshold to $500,000 in 2014, and again in additional increments in subsequent years, thus eliminating the financial audit requirement for certain smaller organizations.

- Electronic Communications. Beginning July 1, 2014, notice of member and director meetings, waiver of notice, and written consent to board action without a meeting may be delivered via fax or email.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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