

# Code of Ethics for Directors of Nonprofit Corporations

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*This Code of Ethics sets forth standards of behavior for directors of nonprofit corporations. It is intended to assist them in fulfilling their duties under the law.*

### 1. BE INFORMED.

Directors owe the nonprofit corporation they serve a duty of care. The duty of care requires them to exercise their authority to make decisions for the corporation with the prudence that an ordinary person would exercise. To be able to fulfill this fiduciary duty of care, it is necessary that the director be well informed about the organization, its mission, its operations and the transactions in which it proposes to engage.

The director should require that management provide him or her financial reports and information adequate for the director to understand the assets, liabilities, revenues, and expenses of the corporation. The information should be adequate to allow the director to make informed and prudent decisions about the budget, the operations and balancing the short term and long term needs of the corporation. Even in large corporations it is important that the director comprehend the full scope of the corporation's finances and operations.

The director should have access to a wide range of information about the corporation and its operations. Management should report regularly to the board and answer questions that directors may have. In most circumstances, it is difficult for the directors to satisfy their duty of care unless they review information provided to them prior to the meeting.

### 2. PARTICIPATE.

Each director must regularly attend and participate in the board meetings. It is not possible to satisfy the duty of care without doing so. In addition, the board must meet regularly. If the board is not meeting regularly, it is incumbent upon the directors to request such meetings. Participation in board meetings can be in person or through a communications device (such as a conference telephone) that allows all at the meeting to hear the others. Proxies are not permitted at the board level.

### 3. USE INDEPENDENT JUDGMENT.

As a director votes on matters before the board, the director must exercise independent judgment on the matter at hand. The director may seek advice and input from staff, consultants and other directors; however, ultimately the director must decide independently based upon his or her understanding of the situation. A director should not vote yes or no merely because someone else is doing so. A director should not "rubber stamp" the recommendations of others. A director should not vote on something he or she does not understand.

### 4. ACT IN BEST INTERESTS OF THE CORPORATION.

A director also has a duty of loyalty to the corporation, i.e., the director must act in the best interests of the corporation and not his or her own personal interest or even the interest of some third party. A nonprofit corporation should maintain a conflict of interest policy to assist the directors in fulfilling this duty.

### 5. DISCLOSE CONFLICTS.

Because a director must act in the best interest of the corporation, it is necessary that the director disclose any facts that may cause the director to be unable or appear to be unable to fully fulfill his or her duty of loyalty. Normally, directors make an annual written disclosure of the relationships that might constitute a conflict, such as where the director is employed and what his or her significant ownership interests are and other boards on which he or she may serve. In addition, as circumstances arise, the director should disclose any actual or potential conflict when the board (or committee) considers a transaction. The corporation should have a policy to address those transactions that create a conflict so that "independent" directors or other appropriate body will have the responsibility for deciding whether to approve the conflicted transaction. The directors should be certain that the procedure designed to deal with any such transaction is fully implemented each time a conflict arises.

### 6. RECUSE.

After disclosing an actual or potential conflict of interest, the director should leave the room while the matter is discussed and should not vote on the matter. Notwithstanding the fact that some state laws allow the conflicted director to be considered for purposes of ascertaining a quorum, the better practice is to assure that a quorum consisting of unconflicted directors is available. The conflicted director should not attempt to influence the decision in any way, but may provide information requested by the board.

### 7. MAINTAIN CONFIDENCES.

A director will frequently receive confidential information about the corporation. For example, the director will be familiar with the corporation's strategic plan, growth plans, litigation, etc. The director is obligated to keep such information confidential. The director should not be discussing such information with non-directors unless specifically instructed by the board to do so. The director should be alert to circumstances where confidentiality obligations may create a conflict. For example, a director employed by a body that funds the corporation on whose board the director serves may not share with his or her employer confidential information about the corporation.

## 8. ACCEPT ONLY REASONABLE COMPENSATION.

In many communities, directors of nonprofit corporations are not compensated for their services, although they are sometimes reimbursed for out-of-pocket expenses associated with the board service. If, however, a director is being compensated, the amount of the compensation must be reasonable in light of the services provided. The board should seek out comparable information to assist it in determining whether the compensation is reasonable. In addition, the compensation should be structured in a manner that will not adversely affect the corporation's tax-exempt status.

## 9. SUPPORT THE CORPORATION.

The director should support the corporation he or she serves. The support should include financial support and, where applicable, public support of the mission of the organization.

Kirkpatrick & Lockhart Preston Gates Ellis LLP has prepared this handbook as a service to the nonprofit community and the many individuals who serve as directors of nonprofit corporations. It summarizes the duties of directors of nonprofit corporations, provides general background information regarding selected available federal tax exemptions and laws regulating charitable solicitations and provides practical advice for minimizing liability arising out of service as a director of a nonprofit corporation. It is not intended to serve as legal advice on any particular matter. Users should consult counsel knowledgeable about nonprofit corporations for legal advice.

This Handbook applies to nonprofit corporations engaged and doing business in the U.S. It does not apply to nonprofit organizations or charities engaged or doing business in any other jurisdiction, including without limitation, the United Kingdom.

Questions regarding the information provided in this handbook can be directed to:

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