

Important Changes to New York Non-Profit Law

Imminent changes to the New York non-profit law will require many non-profit organizations, including private foundations, to update their governing documents and policies.

The Non-Profit Revitalization Act of 2013 (the "Act") was signed into law on December 18, 2013. The Act makes significant changes to laws applicable to non-profit organizations formed, operating or soliciting donations in New York. Except as otherwise noted, the provisions of the Act described below will become effective on July 1, 2014.

Some of the key provisions of the Act are:

- A requirement that all non-profit organizations have a conflict of interest policy;
- A requirement that transactions between a non-profit organization and a related party be approved in accordance with procedures set forth in the Act;
- A prohibition against an employee of a non-profit corporation serving as the chair of the board of directors;
- A requirement that a non-profit organization with 20 or more employees and significant revenue have a whistleblower policy; and
- Changes to the financial reporting requirements for certain non-profit organizations that solicit donations in New York.

Conflicts of Interest and Related Party Transactions

Mandatory Conflict of Interest Policy

Each New York non-profit corporation and charitable trust¹ will need to adopt a new conflict of interest policy that complies with the requirements of the Act. Further, each organization will now be required to collect annual written statements from all directors or trustees regarding potential conflicts.

¹ A "charitable trust" is a trust established solely for charitable purposes (such as a private foundation established as a trust) or a trust that continues solely for charitable purposes after all noncharitable interests have been terminated.

The conflict of interest policy must include:

- A definition of the circumstances constituting a conflict of interest;
- Procedures for disclosing conflicts to the audit committee or, if there is no audit committee, to the board of directors or the trustees;
- A requirement that a person with a conflict not be present at or participate in deliberations or voting on the matter giving rise to the conflict;
- A prohibition against any attempt by a person with a conflict to influence improperly the deliberations or voting on the matter giving rise to the conflict;
- A requirement that the existence and resolution of the conflict be documented in the organization's records;
- Procedures for disclosing, addressing and documenting related party transactions (discussed further below); and
- A requirement that each director and trustee, before his or her initial election or appointment and annually thereafter, sign a written statement disclosing any potential conflicts of interest or stating that there are none.

Related Party Transactions

A New York non-profit corporation or charitable trust will be prohibited from entering into a related party transaction unless the transaction has been approved in accordance with the procedures set forth in the Act.

A related party transaction is defined as any transaction between a non-profit organization or an affiliate of the organization and a related party who has a financial interest in the transaction. The term "related party" is defined broadly to include (i) any director, trustee, officer or key employee² of the organization or of an affiliate of the organization (a "key individual"), (ii) any relative³ of any key individual and (iii) any entity in which a key individual or a relative of a key individual has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%.

Prior to entering into a related party transaction, the board of directors or the trustees must make a determination that the transaction is fair, reasonable and in the best interest of the non-profit organization.

² A "key employee" is any person who is in a position to exercise substantial influence over the affairs of the organization.

³ "Relatives" of an individual are his or her spouse or domestic partner, ancestors, siblings, children, grandchildren, great-grandchildren and spouses of siblings, children, grandchildren and great-grandchildren.

Further, if the related party has a financial interest in the transaction that is “substantial” (a term not specifically defined in the Act), a heightened review process is required. In such a case, the board of directors (or an authorized committee) or the trustees must (i) consider alternative transactions, (ii) approve the transaction by a majority of the directors or trustees present at the meeting and (iii) contemporaneously document the basis for approval, including consideration of alternative transactions.

No related party may participate in deliberations or voting with respect to the related party transaction.

As a result of these provisions, a related party transaction will be prohibited if there are no disinterested directors or trustees to approve the transaction. For example, the sole trustee of a charitable trust may not hire, on behalf of the trust, an investment advisory firm if the trustee has an interest in the firm that fits the “related party” definition.

The Attorney General has significant enforcement authority with respect to related party transactions, including the authority to seek the removal of a director, trustee or officer and, in the case of willful and intentional conduct, to seek damages of up to double the amount of any improperly obtained benefit.

Changes to Corporate Governance Rules for New York Non-Profit Corporations

The Act amends certain corporate governance rules applicable to New York non-profit corporations. Some of the notable changes are summarized below.

Employees Prohibited from Serving as Chair of the Board

Effective January 1, 2015, no employee of a New York non-profit corporation may serve as the chair of the board of directors or hold a position with similar responsibilities.

Expanded Use of Electronic Technology

The Act expands the ability of a New York non-profit corporation to use electronic technology. For example, notices of meetings, waivers of notice, proxy authorizations and actions taken by unanimous written consent may now be accomplished by electronic signatures and email delivery. In addition, board and committee meetings may now be conducted using videoconferencing. New York non-profit corporations may wish to review and, if necessary, update their by-laws to permit the expanded use of electronic technology.

Elimination of Specific Type Designations for Non-Profit Corporations

All New York non-profit corporations will be designated as either charitable or non-charitable. Corporations that have both charitable and non-charitable purposes will be characterized as charitable. These designations replace the prior statutory regime, which categorized non-profit corporations by type (Type A, B, C or D).

Whistleblower Policy Required for Certain Non-Profit Organizations

Each New York non-profit corporation and charitable trust with 20 or more employees and annual revenue over \$1 million will be required to have a whistleblower policy that complies with the Act.

The Act sets forth detailed requirements for the whistleblower policy, including that the policy contain appropriate procedures for reporting and reviewing alleged violations of law or corporate policy and prohibit retaliation against individuals reporting such violations. The whistleblower policy must be distributed to all directors, trustees, officers and employees and to certain volunteers.

**Financial Reporting Requirements
for Non-Profit Organizations Soliciting in New York**

Independent CPA Review or Audit

If a non-profit organization is required to register with the New York Attorney General to solicit donations in New York (a “soliciting charitable organization”) and has annual revenue in excess of certain thresholds, the soliciting charitable organization must file annual financial reports with the Attorney General that contain either a CPA review report or a CPA audit report.

Under the Act, the annual revenue thresholds for CPA review reports and CPA audit reports will increase as reflected in the following chart.

<u>Effective date</u>	<u>CPA Review Report (annual revenue threshold)</u>	<u>CPA Audit Report (annual revenue threshold)</u>
Current	\$100,000 - \$250,000	In excess of \$250,000
July 1, 2014	\$250,000 - \$500,000	In excess of \$500,000
July 1, 2017	\$250,000 - \$750,000	In excess of \$750,000
July 1, 2021	\$250,000 - \$1,000,000	In excess of \$1,000,000

Independent Audit Oversight

If a soliciting charitable organization is required to file a CPA audit report, the “independent” directors or trustees, as defined in the Act (or an audit committee consisting of independent directors or trustees), are responsible for oversight of the financial reporting and audit process.⁴

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⁴ For corporations with annual revenue of less than \$10 million, this provision is not effective until January 1, 2015.

Please contact one of the attorneys in our Private Clients and Charitable Organizations Practice Group if you would like to discuss the application of the changes in the New York non-profit law to your non-profit organization.

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