

Governance implications of New York's Non-profit Revitalization Act

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ISSUE:

What are the implications for non-profit organizations following New York's proposed legislative changes to non-profit corporation law, and what are the potential action steps required by institutions?

RESPONSE:

The New York State Legislature recently passed the New York Nonprofit Revitalization Act of 2013 ("Act") to overhaul the state's non-profit laws, in the first major revision in more than 40 years. If signed into law, the Act is expected to go into effect July 1, 2014. It seeks to make New York more welcoming to non-profits incorporated in the state, and to all non-profits soliciting charitable contributions in New York, by setting forth clearer expectations of board duties in key areas and streamlining certain administrative and operating requirements. Key provisions of the Act are rules for simplified non-profit incorporation processes, clearer financial reporting and audit procedures, and non-profits' adoption of whistleblower and conflict of interest policies. The Act also streamlines rules concerning significant corporate events, real estate transactions, and related-party transactions; sets certain privacy protections for directors and officers; calls for clearer lines of accountability between management and board; and addresses executive compensation.

If Governor Cuomo signs the Act into law, over the course of 2014 through 2015, in order to be in compliance, many non-profit organizations, that are incorporated in New York or that solicit in New York will need to review their existing policies and procedures and, likely, adopt additional ones. Some may also need to implement certain changes in governance to ensure compliance with applicable provisions of the new law.

This Practice Note is based on a regulatory update from the law firm McGuireWoods, the full version of which is available (with Russell client login) at: https://clientlink.russell.com/strategic_advice/regulatory_updates/non_profit_orgs/default.aspx

Background

During Spring 2013, the New York State Legislature unanimously passed The Non-Profit Revitalization Act of 2013, a bill undertaking the first major overhaul of New York's non-profit laws in more than 40 years. If signed into law by New York's governor, the Act will go into effect July 1, 2014. The Act aims to eliminate administrative red tape that is needlessly confusing and burdensome to non-profits and that often prompts New York-based non-profit organizations to incorporate in another state with more favorable laws, such as Delaware. The Act applies not only to New York-incorporated non-profits, but also, in some of its provisions, to non-profits incorporated outside New York that are registered to solicit charitable contributions in New York.

Generally, the Act has three purposes:

1. to eliminate unnecessary administrative and procedural burdens,
2. to modernize the New York non-profit law, and
3. to promote strengthening of non-profits' governance through compliance with certain best practices that many non-profits may already be following.

Several of the impending changes may create practical challenges for some non-profits, which may need to make significant governance and oversight changes in order to comply with the new law.

Key changes summarized

Elimination of letter types

One of the most significant changes in the Act is the replacement of New York's unique taxonomy of four types of non-profit corporations (Types A, B, C and D) with two types of nonprofit corporations – charitable and non-charitable. The Act aims to eliminate widespread confusion about the Types¹ and to simplify the process of incorporation for non-profits in New York, thereby reducing startup costs and delays and averting complications, such as those concerning federal tax exemption. Under the Act, non-profits formally known as Types B and C entities, as well as Type D entities formed for a charitable purpose, will be designated "charitable" corporations. Type A and all other Type D entities will be designated "non-charitable" corporations.

Required financial reporting and audit procedures

From July 1, 2014 to June 30, 2017, the Act outlines a three-tier sliding scale for financial reporting and audit requirements, based upon gross revenue and support, for every charitable organization incorporated in, or required to be registered to solicit charitable contributions in, New York.

1. A non-profit below the \$250,000 level in annual gross revenue and support can continue to file an unaudited financial report;

2. between \$250,000 and \$500,000, an annual financial report accompanied by an independent CPA's *review* report that accords with the Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants;
3. above \$500,000, a report accompanied by an independent CPA's *audit* report containing an opinion that the "financial statements are presented fairly in all material respects and in conformity with generally accepted accounting principles."

To reduce the burden on smaller non-profits, the upper threshold of the revenue and support levels increases on July 1, 2017, from \$500,000 to \$750,000 and again on July 1, 2021, from \$750,000 to \$1,000,000.

With respect to the board's handling of audit functions, the Act also improves requirements, such as requiring boards of non-profits with annual gross revenue and support in excess of \$1 million to review the scope of the audit with the auditor before commencement of the audit, and to discuss material risks and weaknesses after the audit. The purpose of this provision is to ensure that boards are aware of, and that they respond to, issues and risks identified by auditors.

Mandatory whistleblower policy

The Act requires every non-profit with 20 or more employees and annual revenue in excess of \$1 million in the prior fiscal year to adopt a whistleblower policy. Among other things, the whistleblower policy must set forth a requirement that an employee, officer, or director be designated to administer the policy and its procedures for reporting suspected violations, including procedures for preserving the confidentiality of reported information.

Mandatory conflict of interest policy

The Act requires every non-profit to adopt a conflict of interest policy to ensure that its directors, officers, and key employees act in the non-profit's best interests. This provision applies to *all non-profits incorporated in or conducting charitable solicitations in New York*. The only exception to this rule is when a non-profit has adopted a conflict of interest policy pursuant to any other law wherein provisions are substantially similar to the provisions set forth in the Act.

Other significant changes include:

- Allowing non-profits to go through a one-step (instead of two-step) approval process for any **significant corporate events**,
- Reducing voting requirement for **real estate transactions** from two-thirds vote to majority approval for non-profits with less than 21 directors, unless the transactions involve property that constitutes all or substantially all of the non-profit's assets,
- **Modernization of board procedures and meetings**, to allow electronic and video modes of communication, and

- Broadening **related-party transactions** disclosures to “key employees,” defined as any in a position to exercise substantial influence over the affairs of the non-profit.

Other significant provisions of the Act seek to establish greater clarity around Board Chair requirements, to ensure independent board leadership and improve accountability between management and the board; executive compensation; privacy of directors and officers; definitions of “independent director” and “entire board”; and incorporation rules for non-profits with educational purposes.²

Implications for non-profits

Current New York law and regulatory practices can place unnecessary and costly burdens on the non-profit sector. The Non-profit Revitalization Act of 2013 signals lawmakers’ commitment to reducing redundancies throughout the system that not only waste non-profit resources but taxpayers’ dollars as well. The Act seeks to make New York more welcoming for non-profits incorporated in or conducting charitable solicitations in

New York, by setting forth clearer expectations of board duties in key areas and streamlining certain administrative and operating requirements.

To be in compliance, however, many non-profits will need to adopt additional policies and procedures and to implement certain changes in governance. If this Act passes into law, over the course of 2014 through 2015, non-profit organizations that are incorporated in New York or that solicit in New York should take steps to ensure compliance with applicable provisions of the new law.

¹ Type A non-profits are membership organizations formed for a specific list of purposes including, but not limited to, civic, political, social, fraternal, and athletic, and for professional, trade, or service associations. Type B non-profits are formed for any one or more of the following purposes: charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or animals. Type C non-profits are formed to achieve a public or quasi-public objective. Finally, Type D non-profits are those formed under New York nonprofit law when their formation is authorized by another New York law, regardless of whether their purposes also fall within Types A, B, or C.

² Further provision details can be found in the McGuireWoods regulatory update which is available (with Russell client login) at: https://clientlink.russell.com/strategic_advice/regulatory_updates/non_profit_orgs/default.aspx.

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