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NONPROFITS

Nonprofit directors need to be vigilant in board oversight

By Kelvin H. Taketa

If you are reading this column, it is likely that you are among the thousands of Hawai'i residents who serve on the board of a nonprofit organization.

Most of us join these boards because we believe in the mission and like the people involved in the organization.

But these commitments come with important responsibilities that are increasingly defined both by law and by public demand for accountability in the sector.

Recently, the state attorney general's office investigated eight Hawai'i nonprofits that allegedly made loans to officers and directors. Since Hawai'i first adopted the Model Nonprofit Corporation Act in 1985, loans have been prohibited to officers and directors of nonprofit corporations.

While no enforcement action was taken because there was no financial loss to any of the organizations, it is important to note that the investigation focused on the role of the board in reviewing and approving these transactions as well as the nature of the transactions themselves.

"The fact that out of thousands of Hawai'i nonprofits, only a handful have run afoul of this prohibition demonstrates that Hawai'i does not have a serious problem in this area of nonprofit governance," said Deputy Attorney General Hugh R. Jones. Instead, the attorney general's office hopes that the results of its investigation can be used to help educate the mostly volunteer boards of Hawai'i's nonprofit organizations about several prohibitions that are little understood.

For example, many board members do not know that Hawai'i's nonprofit corporation laws prohibit appointing non-directors to a board committees if the committee will exercise board authority.

The commentary to the revised Model Nonprofit Corporation Act does not explain why committee members must be directors.

"But presumably it is because committees have the power to exercise the board's authority, and should be held to the same standards of conduct as directors," Jones said.

While the laws do allow for the creation of board committees that may exercise the board's authority to the extent specified by the board, there are certain transactions that a committee may not approve.

For instance, a committee may not approve distributions or mergers, appoint or remove directors, or amend the articles or bylaws of the corporation.

There are also amendments to the law that took effect in July.

Now, Hawai'i nonprofits that are organized for charitable purposes under IRC section 501(c)(3) must give notice to the attorney general of certain corporate transactions and proceedings, such as mergers, derivative actions and dissolution proceedings.

In addition, these amendments limit the ability of charitable corporations to merge with other corporations without a court order.

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Further, the amendments permit the attorney general to seek the removal of a director or directors of a charitable corporation if a director has engaged in dishonest or fraudulent conduct, breached fiduciary duties, or if a court judgment finds that the director violated his or her duties under the nonprofit laws.

The law also provides authority to the attorney general to approve transactions in which a nonprofit engages that involve a conflict of interest for one of its directors.

This process would provide a mechanism for nonprofits to go forward with conflict transactions where it lacks necessary votes of disinterested directors.

Board members should take the time to review the Hawaii's Revised Model Nonprofit Corporation Act. (A link to the statute is available on our Web site, hawaiicommunityfoundation.org.)

It defines the statutorily imposed duties of board members as the primary source of accountability for nonprofit institutions.

But equally important is the recognition of board members that the public relies on them to ensure that the organization spends its resources wisely in furtherance of valuable public purpose.

Growing sentiment for public accountability by charities has changed the notion of boards as passive entities and their members as being there in "name only."

As a board member, the public views your involvement as an endorsement of an organization's effectiveness and integrity. Board members must be fully engaged in the oversight of their organizations' operations and must actively seek the knowledge required of them.

Additional resources are available for board members as well as registration information for the foundation's upcoming Board Leadership Conference on Sept. 15 at hawaiicommunityfoundation.org.

Public charities and private foundations with questions about the 2004 amendments, or about prohibitions on loans to directors and officers, may also contact Jones at 586-1470 for more information.

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