

# Key Issues in Nonprofit Governance

AAA EA WEBINAR

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# Overview

- Some Key Basics and Terminology
- Individual Director Duties of Care, Loyalty and Obedience
- Collective Role and Duties of the Board
- Risks of Personal Liability
- Accountability
- Transparency
- Financial Policies and Internal Controls

# Key Basics and a Word on Terminology

- Sources of Law and Guidance: State Law, IRS, Courts and “Best Practices”
- Single Board vs. Two-tier structures
- “Trustee” = “Director” under State Law
- Trustee, Director, Officer, Staff (paid employees/contractors), Volunteers, Members, Public



# The Trustee or Director: Duties of Care and Loyalty

# The Individual Trustee/Director: Duties of Care and Loyalty

- Fiduciary Duties
  - Your Board of Directors has the ultimate responsibility and authority for managing the organization's affairs
  - State nonprofit law imposes on Directors the obligation to act in the best interests of the organization

# The Individual Trustee/Director: Duties of Care and Loyalty

- The Law requires the Director to act:
  - In good faith;
  - With the **care** an ordinary **prudent person** in a like position would exercise under similar circumstances; and
  - In a manner the Director **reasonably believes** to be in the **best interests** of the organization

# Duty of Care

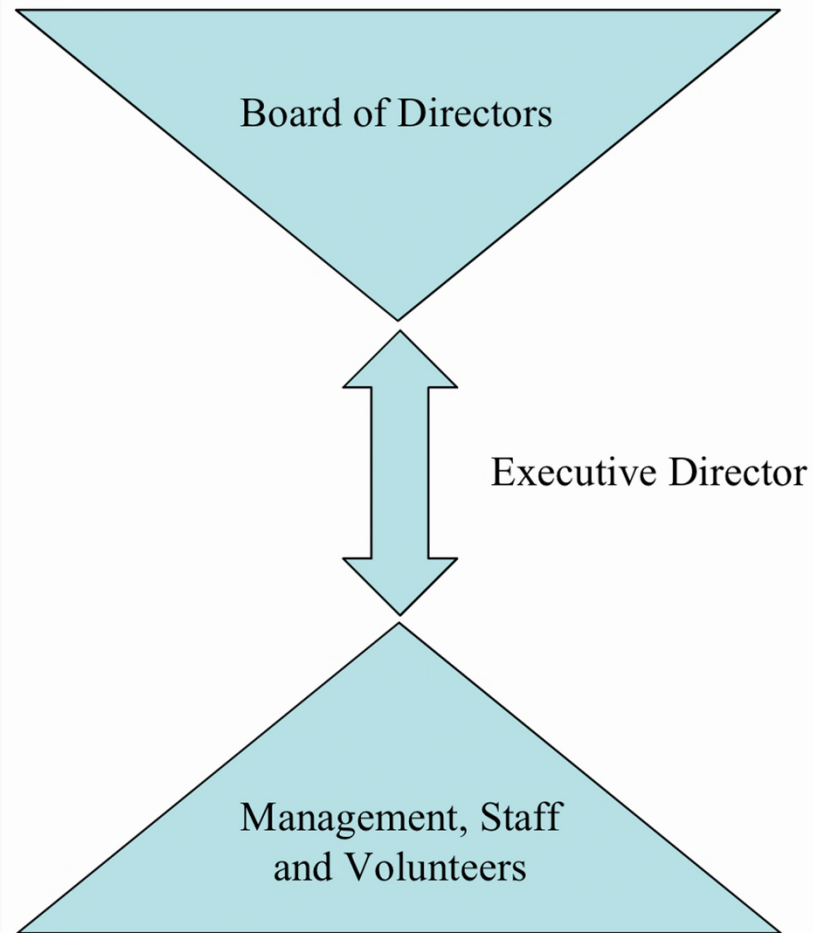
- Attendance at meetings
  - Absolute must
  - Courts have little sympathy for lack of knowledge based on lack of attendance
  - Directors bound by Board decisions regardless of attendance and will still be liable if Board action is negligent or unlawful
  - Failing to attend meetings is in itself negligent; repeated failure is the basis for resignation or grounds for removal

# Duty of Care

- Delegation vs. Abdication
  - Board - generally decides on policy matters; relies on others to carry out decisions
  - Board may delegate its duties to committees or outside parties, such as accountants, attorneys or other professionals
  - Must supervise those to whom authority was delegated
  - Delegation does not relieve a Director or the Board collectively of liability



# Common Structure



# Duty of Loyalty

- Director commits allegiance to the organization
- Acknowledges that the best interests of the organization must prevail over any individual interest of the Director, or his or her family or associates

# Duty of Loyalty

- Transgressed when Director uses his or her position to promote, advance or effectuate a transaction that is:
  - (1) Between the organization and such person or his or her relatives or associates; and
  - (2) Not substantially fair to the organization

# Duty of Loyalty

- Full disclosure and abstention from discussion and voting required when a Director may be influenced by a private interest
  - Procedures detailed in a conflicts of interest policy
  - Who decides whether there is a conflict?
- Disinterested Directors have the duty to:
  - Obtain all the information they need
  - Be prepared and informed
  - Speak their minds and ask hard questions
  - Hold the organization's interests foremost when voting

# Collective Role and Duties of the Board

# Collective Role and Responsibilities of the Board of Trustees/Directors

- Setting policy and directives consistent with the mission of the organization
- Selection and oversight of the Executive Director and senior management/officers
- Serving as a “bridge” and a “buffer” to the outside world
  - “Bridge” --> Directors represent, advocate, raise awareness, solicit contributions, etc. with the outside world (e.g., local government, businesses and other community groups)
  - “Buffer” --> Sensitivity to the outside world; provide feedback to management

# Collective Role and Responsibilities of the Board of Trustees/Directors (cont.)

- Financial Stewardship
  - Approving the annual budget
  - Approving major financial commitments
  - Approving deviations from the budget
  - Playing a major role in fundraising campaigns

# Collective Role and Responsibilities of the Board of Directors (cont.)

- Ensure that the Board has the right skills to do its job
  - 1st Priority: Need individuals who are deeply committed
  - 2nd Priority: Need variety of skill-sets (e.g., accounting, management, marketing, information technology)

OR at least 1 of the 3 “W’s”: “Work, Wisdom or Wealth”

- Monitor compliance with all applicable laws with organization’s internal policies and procedures (i.e., the bylaws, fiscal procedures, conflicts of interest policy and any other adopted policies)



# Top 10 Nonprofit Governance Mistakes (from a Lawyer's Perspective)

1. Failing to understand the Board's fiduciary duties.
2. Failing to provide effective oversight.
3. Over Deference to the Executive Committee, Board Chair or the Founder.
4. Micro-management.
5. Avoiding the hard questions.

# Top 10 Nonprofit Governance Mistakes (from a Lawyer's Perspective) (cont.)

6. Insufficient conflict management.
7. Lack of awareness of laws or bylaws.
8. Operating with outdated, inconsistent governing documents.
9. Airing disagreements outside of the board.
10. Failure to cultivate board diversity.



# Risks of Personal Liability

# Risks of Personal Liability

- Directors face potential personal liability on a variety of grounds:
  - Liabilities to third parties (e.g., contractual matters)
  - Employees claiming wrongful termination
  - Independent contractor vs. Employee – tax withholding requirements
  - Governmental entities (e.g., State Attorney General) claiming waste of charitable assets or violation of laws
  - Students/public claiming negligence in selection and supervision of employees and volunteers
  - Violations of limitations on lobbying and political activities
  - “Intermediate Sanctions”

# Protecting against Personal Liability

- Fulfilling individual duties of care and loyalty
- Four principal shields:
  - ➔ Corporate statutes
  - ➔ State and Federal Volunteer Protection Statutes
  - ➔ Indemnification
  - ➔ D&O Insurance



# Accountability

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- Accountable to whom?
  - “Charitable Class” / Intended Beneficiaries
  - General Public
  - Members (if any)
  - Board
  - Donors
  - Internal Revenue Service
  - State Attorney General
  - Others

# Accountability to the Charitable Class

- Nonprofits must serve a charitable class
- Directors must ensure that their organization is serving that class
- Examples of charitable classes:
  - Immigrants
  - Youth
  - Battered Women
- Directors can start doing this by understanding the identity of the charitable class



# Accountability to the Members

- Many nonprofits are membership-based
- Members are typically granted rights to elect and remove directors and approve fundamental changes
  - Amendments to the NP's articles of incorporation
  - Dissolution of the NP
- Directors must read and abide by the Bylaws

# Accountability to Donors

- Accountability may arise under the terms of a donor's contribution ("restricted funds")
- NP staff must be sensitive to donor concerns and expectations
- Do not accept a contribution if:
  - the terms of such contribution are inconsistent with your organization's purposes; and
  - the organization is not able to comply with the terms
- Example: Social service agency permits a donor to contribute funds and then dictates to the NP to send those funds to the donor's poor relatives overseas

# Accountability to the General Public

- No legal duty to the general public
- Public and press is aware of the NP through its:
  - Fundraising materials
  - IRS Form 990
  - NP's website
  - NP's activities
- Directors must be sure that all representations of their NP are consistent with its purposes and operations

# Accountability to the IRS and the State Attorney General

- IRS: Oversees the nonprofit through annual tax disclosures (IRS Form 990) and periodic audits
- IRS: Tax exemption is a privilege and may be withdrawn by the IRS upon audit
- IRS: Can use “intermediate sanctions” on excess benefit transactions
- State Attorney General: Oversees the nonprofit on behalf of the charitable class; level of oversight varies by state

# Accountability to Others

- A nonprofit, like any entity, is accountable to:
  - ➔ Employees
  - ➔ Volunteers
  - ➔ Service providers
  - ➔ Donors

# The Independent Sector's “Checklist for Accountability”

1. Develop a culture of accountability and transparency
2. Adopt a statement of values and code of ethics
3. Adopt a conflict of interest policy
4. Ensure that the Board of Directors understand and can fulfill its financial responsibilities
5. Conduct independent financial reviews, particularly audits
6. Ensure accuracy and make public your Form 990
7. Be transparent
8. Adopt a “Whistleblower Policy”
9. Remain current with the law



# Transparency

# Transparency & Form 990 Rules

- To improve transparency, make the following information easily accessible:
  - Vision and mission statements
  - Statements of values and code of ethics
  - Conflict of Interest policy
  - Form 990's
  - Most recent audited financial statements
  - Programs and activities



# Transparency & Form 990 Rules

- Information on evaluation procedures
- Annual Reports
- Information on accreditations/certifications/standards
- List of board members and officers
- General information on contributors
- Bylaws and Articles of Incorporation

# Financial Policies and Internal Controls

# Safeguarding your Organization's Assets: Financial Policies and Internal Controls

- Preparation and approval of an annual budget
- Directors should expect management to produce thorough income and expense statements, balance sheets and budget status reports
- Once your organization reaches a certain size, board should retain outside auditor and review the auditor's report
- Use of experts reflects prudence

# Safeguarding your Organization's Assets: Financial Policies and Internal Controls

- Policies should be adopted and followed to ensure assets are not misapplied or wasted
- Sample policies:
  - ➔ Conflict of Interest Policy
  - ➔ Compensation Policy
  - ➔ Donation Policy
  - ➔ Travel Policy
  - ➔ Expense Policy

# Safeguarding your Organization's Assets: Financial Policies and Internal Controls

- Constant, vigilant eye towards protecting (and enhancing) your organization's most important asset:

## **GOODWILL**

# Questions & Answers / Discussion

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