FROM: D.C. BAR PRO BONO PROGRAM

INTRODUCTION

Over the past several years, many groups and organizations have placed a great emphasis on nonprofit governance. Watchdog groups, such as the Better Business Bureau's Wise Giving Alliance and Charity Navigator regularly rate charities based in large part on the organization's governance structure. State regulators also require nonprofits to provide more information about their governance structures, and donors, foundations and the press also have placed a greater emphasis on nonprofit governance. In fact, many of the recent nonprofit scandals have been traced back to insufficient oversight of the charity's operations by the organization's board of directors.

Finally, the IRS has redesigned the Form 990, the reporting form that most charities must file with the IRS on an annual basis. On the revised form, the IRS asks for much more detailed information about the nonprofit organization's governance practices and policies.

The DC Bar Pro Bono Program wants to assist you with strengthening your organization's Board governance. One of the most critical ways to assist Board members is by educating them about their fiduciary duties. As the Independent Sector states in its *Guide for Good Governance and Ethical Practice*:

> The board should establish an effective…process for educating …board members to ensure that they are aware of their legal and ethical responsibilities, are knowledgeable about the programs and activities of the organization, and can carry out their oversight functions effectively…An effective board orientation process fills this need by detailing the broad oversight responsibilities of the board and the specific legal and ethical responsibilities of individual members.

To help you with this task, the DC Bar Pro Bono Program is happy to provide you with the attached manual entitled ***Welcome to the Board of Directors***.

PURPOSE OF MANUAL

The purpose of this manual is to provide your organization with a template that will help you develop an orientation manual for new and existing directors. This manual:

- Allows you to set forth the mission and goals of your organization
- Sets forth the basic legal responsibilities for members of the Board of Directors;
- Discusses the Board's role in overseeing the financial and fundraising practices of the organization;
- Describes the safe harbor requirements for setting executive compensation;

- Emphasizes the importance of evaluating the performance of management and the board; and
- Discusses the Board's role in risk management and strategic planning.

HOW TO USE THE MANUAL

This manual is a template for you to adapt to meet the needs of your organization. You will need to add certain information about your organization, so that it meets your needs. As you read through the manual, you will notice that there are blank sections for you to complete. For example, in Section One, you will need to add information about your organization's programs, history and major accomplishments.

In addition, there are certain words that you will need to replace throughout the manual. These are designated as follows:

[….]

Each time you see words in brackets and in bold type, this means you need to substitute the correct words for the bracketed words. For example, when you see **[Insert name of nonprofit]**, you should replace the bracketed words with the name of your nonprofit. Thus, if your organization's name is The Very Useful Charity of Greater Washington, you should replace **[Insert name of nonprofit]** with The Very Useful Charity of Greater Washington every time it appears in the text.

You will also see **[chief paid staff member].** Replace this term with executive director, CEO or whatever other title you use for the most senior member of your staff. Similarly, when you see **[chief financial officer]** you may want to keep that title, if that is what you call your top finance staff member, or you may want to replace it with Director of Finance or other title.

Finally, in the footer at the bottom of each page, please insert the month, day and year that you prepare the manual, and change the date every time that you updated the manual. This will allow you to keep track of when the manual was last updates, and you will know if the manual has been changed to incorporate any changes in your structure, policies, etc.

Before you adapt this manual for your organization's use, you should consult with an attorney. The attorney will help you adapt the manual so that the information is legally correct and is best suited for your organization.

APPENDIX

In addition, we have prepared a sample appendix, with a suggested list of documents and policies you should provide new directors for their reference. Throughout the manual you will see references to various policies and procedures that your organization may want to adopt.

The appendix contains samples of such policies, such as conflict of interest and record retention policies. If your organization has already adopted one of these policies, you should substitute it for the sample policy in the appendix. If there is a policy that you have not adopted but want to adopt, you may use the sample policy in the appendix as a template for developing a policy for your organization. If there is a reference in the manual to a policy you do not wish to adopt, you should delete the reference when it appears in the manual.

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Welcome to the Board of Directors

An Orientation Manual for New Directors
of
[Insert Name of Nonprofit Organization]

Table of Contents

Welcome to the Board of Directors. We appreciate your willingness to serve. **[Insert name of nonprofit]** fills an important need in our community, and we believe that you will find serving on the Board a rich and rewarding experience.

As a director, you are responsible for overseeing the operation of **[Insert name of nonprofit].** Along with your fellow members of the Board of Directors, you are responsible for maintaining the commitment to our organization's mission, establishing our strategic direction, ensuring our compliance with all applicable legal requirements, and maintaining our organization's financial well-being. This involves a great deal of responsibility. The purpose of this manual is to help you understand your rights and responsibilities as a director so that you can effectively carry out these duties. We encourage you to refer to it whenever you have questions about your Board service.

Before you begin reviewing this manual, you should remember that you are not alone. When exercising your responsibilities, you may draw from the expertise of your fellow directors and management. Also, you may rely on the expertise of individuals retained by **[Insert name of nonprofit]** to assist the organization in carrying out its duties. These individuals include the following people:

Legal Counsel:
[Name]
[Firm Name]
[Address]
Telephone No:
E-Mail:

Independent Auditors:
[Name]
[Firm Name]
[Address]
Telephone No:
E-Mail:

Insurance Broker:
[Name]
[Firm Name]
[Address]
Telephone No:
E-Mail:

In addition, there are several resources available to help you carry out your work. These include:

Center for Nonprofit Advancement—The center assists nonprofits by providing them with education and training, networking, advocacy, and buying opportunities, including health and liability insurance.
www.nonprofitadvancement.org

Philadelphia LawWorks, the Community Economic Development Project of Philadelphia VIP- LawWorks refers eligible nonprofits, small businesses and homeowners to lawyers who provide free legal services. For more information about LawWorks and to obtain an application for free legal services, go to www.phillyvip.org

Board Source—Board Source provides resources for nonprofit leaders through assessment tools, membership program, training, an extensive Web site, and workshops. It also provides governance consultants who work directly with nonprofit leaders to design specialized solutions to meet an organization's needs.
www.boardsource.org

Foundation Center—The center maintains the most comprehensive database on U.S. grant makers and their grants; issues a wide variety of print, electronic, and online information resources; conducts and publishes research on trends in foundation growth, giving, and practice; and offers an array of free and affordable educational programs.
www.foundationcenter.org

Thank you again for your willingness to serve our great mission. Welcome aboard!

1. History and Mission of **[Insert name of nonprofit]**

A. **<u>Mission Statement</u>: [Insert name of nonprofit]** is a nonprofit, tax-exempt organization whose mission is **[Insert mission statement].**

As a director, your first job is to serve **[Insert name of nonprofit]**'s mission and to ensure that activities carried out by the organization help further that mission. When reviewing the organization's budget and future activities, you should evaluate them against the mission statement and determine whether the proposed use of **[Insert name of nonprofit]**'s assets is consistent with the organization's mission and its tax-exempt status under the Internal Revenue Code.

B. **History of the Organization: [Insert name of nonprofit]** was founded in _______ by ______________.

C. **Programs and Services:**

D. **Recent Accomplishments:**

2. Fiduciary Responsibility of a Member of the Board of Directors

As a director, you have certain legal responsibilities that you must follow. This section is designed to give you some of the information you need to carry out those responsibilities. However, this material can only provide you with general information. It cannot answer every situation that may arise and should not be construed as legal advice. Therefore, if the Board has a specific situation with respect to which it needs guidance, it should consult with **[Insert name of nonprofit]**'s legal counsel to determine what is appropriate for the organization. In addition, if you have questions about any potential legal liability you may have as a director, you should consult Section 7 of this manual, Risk Management and Directors' and Officers' Insurance.

A. <u>The Tone at the Top:</u> The "tone at the top" refers to the ethical climate created in an organization by its leadership. Through your leadership on the Board, you can foster a climate whereby the directors, employees, and volunteers act in a manner that upholds the highest ethical standards of **[Insert name of nonprofit]** while carrying out their duties. It is important to create this expectation for yourselves and others. If you and your fellow directors appear unconcerned with maintaining high standards, this attitude will be observed by the employees and volunteers, and it will impact their behavior as well.

In particular, the Board should make clear that, in making decisions, it is doing what it believes is in the best interests of **[Insert name of nonprofit]** to help carry out its mission. It is also the Board's responsibility to ensure that **[Insert name of nonprofit]** fully complies with all applicable federal and Pennsylvania laws and regulations.

In addition, as a director, you are expected to comply fully with **[Insert name of nonprofit]**'s Code of Ethics, which includes the Ethics Policy covering gift acceptance *(see Appendix M*[1]*)* and the Conflict of Interest Policy *(see Appendix K)*. You and the other members of the Board are responsible for ensuring that all others comply with these policies as well. In particular, the Board is responsible for implementing **[Insert name of nonprofit]**'s Whistleblower Policy *(see Appendix N)* and for ensuring that any claims of wrongdoing by a director, officer, employee, or volunteer are fully and fairly investigated, and that there is no retaliation against anyone bringing a claim in good faith.

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[1] The appendix to this manual contains samples policies, such as conflict of interest and record retention policies. If your organization has already adopted one of these policies, you should substitute it for the sample policy in the appendix. If there is a policy that you have not adopted but want to adopt, you may use the sample policy in the appendix as a template for developing a policy for your organization. If there is a reference in the manual to a policy you do not wish to adopt, you should delete the reference when it appears in the manual. [Delete this footnote from final manual]

B. **<u>Duty of Care</u>:** As a director, you must perform your responsibilities with the same care an ordinarily prudent business person would use in managing his or her own affairs. This means that you should act in good faith, stay informed and active, and exercise independent judgment when making decisions on behalf of **[Insert name of nonprofit]**.

The Board should delegate day-to-day duties to **[Insert name of nonprofit]**'s senior management, subject to the Board's review and oversight. The Board may delegate certain Board functions to committees of the Board. The duties that can be delegated to committees of the Board are typically specified in the organization's by-laws. Also, as a director, you may rely upon:

- Information provided by employees as part of their jobs;
- Professional advice of attorneys, independent public accountants, and other experts in their field; or
- Information provided by a Board committee in the course of its assigned work.

However, you may not delegate your personal responsibilities as a member of the Board to others. At the end of the day, you and your fellow directors bear the responsibility for determining what is best for the organization.

<u>Duty of Loyalty</u>: According to Pennsylvania Attorney General Tom Corbett's Handbook for Charitable Nonprofit Organizations, "Board members and senior management must always perform their duties in good faith with the best interests of the organization in mind. This means that they must not seek to derive private gain from business transactions that involve the nonprofit corporation or advance their own interests at the expense of the corporation. Acts of self-dealing constitute a breach of fiduciary duty which may result in personal liability to the nonprofit organization. Board members, trustees, and senior management should avoid conflicts of interest and even the appearance of impropriety. Individuals who take advantage of corporate opportunities to make profits for themselves at the expense of the corporation may be liable for the profits they received at the organization's expense."

The Board has adopted a Conflict of Interest Policy that applies to all directors and senior managers of **[Insert name of nonprofit]** *(see Appendix K)*. **[Insert name of nonprofit]** also asks each director to fill out an annual Conflict of Interest Questionnaire *(see Appendix L)*. As a director, you must familiarize yourself with the Conflict of Interest Policy and ensure that you and your fellow directors comply with it.

C. **<u>Duty of Obedience</u>:** As a director, you also must act in a manner that is consistent with the provisions of the Articles of Incorporation, by-laws, and tax-exempt status of **[Insert name of nonprofit]**. You should be familiar with the mission of **[Insert name of nonprofit]** and act in a manner consistent with such mission. In addition, you must comply with all federal and state laws as they apply to the organization.

D. **<u>Confidentiality</u>:** You should not disclose information about **[Insert name of nonprofit]**'s activities unless the Board decides to make the information public, or unless the information is a matter of public record.

E. **<u>Attendance</u>:** As a director it is important that you demonstrate your commitment to the organization by regularly attending Board meetings and meetings of the committees to which you have been assigned. This will allow you to stay informed of **[Insert name of nonprofit]**'s activities and, in turn, the organization will benefit from the skills you bring to the Board.

There are ways you can attend meetings without being physically present. For example, if not prohibited by the by-laws, you can participate via conference call, provided you can hear all the other participants in the meeting and they can hear you. However, being a member of the Board of Directors is a personal responsibility. You cannot delegate this responsibility to others. Therefore, you cannot give someone else the authority to attend a Board meeting or vote on your behalf. You cannot vote by proxy.

F. **<u>Director's Rights</u>:** As a director, you have certain legal rights. These rights are designed to assist you in carrying out your fiduciary duties as a member of the Board. For example, it is important that you stay informed about **[Insert name of nonprofit]**'s business affairs. Consequently, as a director, you have a right to have reasonable contact with the organization's senior managers to discuss the organization's business affairs. You also have the right to inspect the books and records of the organization and to request additional information from management.

At the same time, you should remember that while the Board retains the ultimate responsibility for the operations of **[Insert name of nonprofit]**, the senior managers are responsible for the day-to-day management of the organization. Your duty as a director is to ensure that they exercise their management responsibilities in a manner that best serves the organization. It is not in the organization's best interests if the Board attempts to review and approve day-to-day management decisions, or substitutes its judgment for that of the senior managers.

Therefore, when you request information from management, it is important that you are reasonable in the frequency and scope of your requests. You want to take care that your requests are suited to what you need to perform your job as a director, and not the day-to-day management of the organization.

Another important way to stay informed about the organization's activities is to review the Board and committee minutes. The Board will be provided with the minutes of the meetings in a timely manner. The Board secretary should prepare the minutes of any Board meeting promptly after the meeting, but at least in time to be approved before the next Board meeting. If, for some reason, you do not receive the minutes of a Board or committee meeting, you have the right to ask for a copy of the minutes.

It is also important that directors attend Board and committee meetings. Therefore, you will be given advance notice of each meeting so that you can prepare for the meeting and plan to attend. The amount of advance notice for each type of meeting is specified in the by-laws. If you do not receive the proper amount of advance notice, you can still attend the meeting and participate.

There may be situations where the fact that you did not receive proper advance notice of a meeting may be detrimental to the organization. In such case, you have the right to object to the fact that you did not receive proper notice of the meeting. However, your participation at the meeting must be limited to making your objection. If you participate in the substance of the meeting, you will be considered to have waived your right to make an objection.

Finally, the organization encourages open and informed debate among the Board directors, which helps ensure that the best possible decisions are made. If you disagree with any action the Board proposes to take, you have the right to vote against the action. In addition, you have the right to have the Board secretary record your objection, by name, in the minutes of the meeting. This is important if you believe that the actions of the Board are not only unwise, but improper. In such case, if you object to the actions and have your objection recorded in the minutes, you may escape liability if the action is later challenged.

G. <u>**Private Inurement and Private Benefit**</u>: The Internal Revenue Code gives tax-free status to charitable organizations because they provide important benefits to the general public. However, the Internal Revenue Code also provides that a tax-exempt organization must be operated for the benefit of the public and not for the benefit of "insiders." This is called the private inurement rule. As a director, you must ensure that insiders do not receive favorable treatment at the expense of **[Insert name of nonprofit]**, otherwise **[Insert name of nonprofit]** would be at risk of losing its tax-exempt status. Some examples include paying more than fair market value for goods or services provided by an insider, or creating a job for someone just because they are related to an insider.

By insiders, the Internal Revenue Service (IRS) refers to anyone with a unique position in the **[Insert name of nonprofit]** so that he or she can exercise control or influence over the organization and the application of its funds or assets. Insiders would include the following individuals:

- **[Insert name of nonprofit]**'s founders;
- Officers;
- Members of the Board of Directors;
- **[Chief paid staff member];** and
- Their relatives such as a spouse, parent, siblings and their spouses, children and their spouses, and great grandparents, grandparents, grandchildren, and great grandchildren and their spouses.

It is permissible to give a benefit to any individual, even a director, that qualifies under **[Insert name of nonprofit]**'s normal charitable guidelines.

In addition, as a director you must make sure that **[Insert name of nonprofit]**'s activities further the public good. Therefore, you should make sure that any business transactions entered into by **[Insert name of nonprofit]** are in **[Insert name of nonprofit]**'s best interests and help it carry out its mission. The assets of **[Insert name of nonprofit]** should not be used to serve a private, as opposed to the public, good. This is called the private benefit rule.

> ➢ *Example:* **[Insert name of nonprofit*]*** *wants to buy a building and it cannot use all of the space immediately. Therefore, the Board decides to rent out the unused space. As a director, you should try to maximize the value of the building to the organization. The organization should not charge any tenant less than market rent simply because the tenant is a friend of a director, or has some other connection to* **[Insert name of nonprofit]** *such as a business relationship. If it does so,* **[Insert name of nonprofit]** *may be in violation of the private benefit rule.*

One exception may be if the tenant is another tax-exempt organization. In such case, it may be acceptable for **[Insert name of nonprofit]** to charge a lower rent or no rent at all to provide assistance to the other charitable organization because it also helps **[Insert name of nonprofit]** carry out its tax-exempt mission.

I. **Board Compensation:** As a director, you will not be compensated for your services. Moreover, you cannot claim a deduction for the value of your donated services to **[Insert name of nonprofit].** You may be reimbursed for any reasonable out-of-pocket expenses you incur on behalf of **[Insert name of nonprofit]**, in accordance with its expense reimbursement policy. The organization will not reimburse a member of the Board of Directors for the cost of his or her spouse's or other dependent's travel to organization events. If you elect not to be reimbursed for your out-of-pocket expenses, you may be able to deduct them as a charitable contribution to the organization.

In addition to your Board service, from time to time it may be in the best interests of **[Insert name of nonprofit]** for you to provide some other goods or services to **[Insert name of nonprofit]**, such as legal or accounting work. If you provide goods or services to **[Insert name of nonprofit]** in addition to serving on the Board, **[Insert name of nonprofit]** is allowed to pay you for your goods or services, provided that:

- The Board approved the transaction before you provided the goods or services in accordance with the Conflict of Interest Policy;
- You received only fair market value for your goods or services; and
- The organization properly documented and reported the transaction.

In the event that you are paid more than fair market value for any goods or services you provide, or the organization fails to properly document or report the transaction, the transaction may be considered an "excess benefit transaction." Under the Internal Revenue Code, you may be subject to penalties if you receive an excess benefit. Therefore, before you enter into any financial transaction with **[Insert name of nonprofit]**, you should consult the organization's legal counsel to ensure that all proper procedures are followed.

J. Political Activity and Lobbying

1. Lobbying

As a tax-exempt entity, **[Insert name of nonprofit]** may engage in limited lobbying activities. For this purpose, **[Insert name of nonprofit]** will be regarded as lobbying if it attempts to influence legislation. Attempting to influence legislation includes contacting or urging the public to contact members or employees of a legislative body for the purpose of supporting or opposing legislation, or advocating for the adoption or rejection of legislation.

Legislation includes actions by Congress, state legislatures, or any other elected body, such as the local city council or school committee, with respect to acts, bills, or resolutions. It applies to such actions as confirming an individual for office, such as a judge or cabinet member. It also applies to ballot initiatives or similar procedures to be voted upon by the public. The definition of legislation does not include actions taken by the courts or government agencies.

As noted above, there are limits on the amount of lobbying in which **[Insert name of nonprofit]** may engage. The Internal Revenue Code provides that a nonprofit that is exempt under Section 501(c)(3) cannot expend a "substantial" part of its activities in lobbying. If **[Insert name of nonprofit]** engages in what is considered excessive lobbying, the organization will be subject to an excise tax and will be at risk of losing its tax-exempt status.

At what point a nonprofit's lobbying is considered "substantial" depends on all the facts and circumstances and is not always clear-cut. Therefore, Congress enacted Section 501(h) of the Internal Revenue Code. By filing an election with the IRS, a nonprofit is allowed to engage in lobbying activities—up to certain dollar limits—without losing its tax-exempt status. The limits are based on the size of the organization's annual revenue. Churches and private foundations are not eligible to make the election, but other nonprofit organizations that engage in lobbying activities commonly do.

As a director, you should ensure that **[Insert name of nonprofit]** complies with the rules against excessive lobbying. In addition, certain lobbying activities may require the organization to register as a lobbyist with various federal and local government authorities. If **[Insert name of nonprofit]** wishes to engage in any lobbying activity, the Board should work with legal counsel and senior management to ensure that procedures are put in place to comply with these regulations and the IRS limitations on lobbying activities.

2. Rules Prohibiting Political Activities

Under the Internal Revenue Code, nonprofit organizations are strictly prohibited from intervening on behalf of, or in opposition to, candidates for local, state, or national office. If **[Insert name of nonprofit]** violates this rule, it is subject to an excise tax on the amount expended on the campaign activity and faces the risk of losing its tax-exempt status.

This does not mean that, just because you are a director of **[Insert name of nonprofit]**, you cannot be involved in political activity as a private individual. However, you may not use **[Insert name of nonprofit]**'s property or other assets, including **[Insert name of nonprofit]**'s name, on behalf of or against any candidate for office. You should also make clear that any political statements you make, such as an endorsement of a candidate, are made in your personal capacity and not in your capacity as a director of **[Insert name of nonprofit]**, and that the statements should not be made at an event sponsored or hosted by **[Insert name of nonprofit]** or in any of its publications.

If you are in any doubt as to whether your activities might be considered improper political activities on behalf of **[Insert name of nonprofit]**, you should consult with the Board officers and legal counsel before engaging in those activities.

K. **Summing Up:** While all these responsibilities may seem like a lot to keep straight, you can broadly summarize your fiduciary duties using the following questions:

- Do you put the organization's interests before your own?
- Do you ensure that others do as well?
- Do you regularly attend Board and committee meetings?
- Do you read the information provided to you as a director or otherwise stay informed?
- Do you exercise your independent business judgment as best as you can?
- Do you do your best to make sure that **[Insert name of nonprofit]** follows the law, including the special rules applicable to nonprofits?
- Do you rely on the advice of **[Insert name of nonprofit]** legal counsel and independent accountants to assist you in your work?

If you follow these steps, you will go a long way towards faithfully carrying out your fiduciary duties as a director and help establish the proper ethical tone for the organization.

3. Fundraising

A. **Fundraising Strategy:** These days, it is not enough for **[Insert name of nonprofit]** to have a good purpose and programs. There are many nonprofits with important missions to fulfill, and there is a limited amount of money to support all their worthy causes. At the same time, without proper funding, **[Insert name of nonprofit]** cannot serve the critical needs of the community it has identified.

Therefore, one of the most important roles of the Board is to define and establish a successful fundraising strategy to sustain the organization's goals. The role of the Board in raising revenue is unique, and it is one of the critical differences between nonprofit and for-profit businesses in the ways they are managed.

The Board has a responsibility to attract resources to sustain the organization's programs and fulfill its mission. The Board must select and support senior management, put the budget in place, and oversee and evaluate the organization's fundraising and financial performance.

Even though the Board is ultimately responsible for **[Insert name of nonprofit]**'s fundraising strategy, the fundraising activities will not succeed without a close partnership with management. There has to be a close collaboration between the Board and management, as well as clearly defined goals for management to execute. Therefore, it is key for the Board to specify the responsibilities of both management and the Board in the fundraising effort. At the same time, it is important to remember that implementing the fundraising plan is a responsibility shared by the Board and should not be left only to management.

B. **Fundraising Practices:** The Board should ensure that **[Insert name of nonprofit]** follows ethical fundraising practices and that its fundraising efforts are cost-effective. It is the Board's responsibility to ensure that **[Insert name of nonprofit]**'s fundraising programs reflect well on the organization and its mission. Therefore, the Board must exercise the following responsibilities:

1. **Designated Donations:** Frequently, a donor will make a contribution to **[Insert name of nonprofit]** and place restrictions on how such funds may be used. For example, the donor may want to fund a specific initiative or activity. Also, as an organization, **[Insert name of nonprofit]** may solicit funds with the promise that the donations will be used for a particular purpose. These are called restricted or designated funds. As a member of the Board, it is your responsibility to ensure these funds are used for the purpose the donor specified, and not for other expenses such as overhead or other program activities. You should ask that any financial reports you receive specify whether the income is restricted or unrestricted, so that you can ensure that the donor's wishes are being carried out.

2. **Gift Acceptance Policy:** From time to time, **[Insert name of the nonprofit]** may be offered donations that would compromise the organization's ethics, financial circumstances, program focus, or other interests. For example, the source of the funds may be one that is inconsistent with the mission **[Insert name of nonprofit]** is trying to serve. Therefore, it is important that the Board has clear standards and procedures for determining when it will not accept a donation. These standards and procedures must be discussed in advance and not after a questionable gift is being offered; otherwise, financial and time pressures on the organization may cause the Board and management to make a wrong decision about whether to accept the gift.

3. **Fundraising Techniques: [Insert name of the nonprofit]**'s most valuable asset is its good name. One way the organization may forfeit its good name is if it engages in inappropriate fundraising practices. In the past few years, newspapers have published several stories of

otherwise legitimate charities that have employed questionable fundraising methods. Therefore, it is important that the Board ensure there is appropriate training and supervision of the people soliciting funds on **[Insert name of nonprofit]**'s behalf, that they understand their responsibilities and do not employ techniques that are coercive, intimidating, or intended to harass potential donors.

4. **<u>Compensation for Fundraisers</u>:** Compensation for fundraising activities should reflect the skill, effort, and time expended by the individual or firm on behalf of **[Insert name of the nonprofit]**. Basing compensation on a percentage of the money raised can encourage fundraisers to put their own interests ahead of those of **[Insert name of the nonprofit]** or the donor, and may lead to inappropriate techniques that jeopardize **[Insert name of the nonprofit]**'s values and reputation as well as the donor's trust in the organization. Many professional fundraising associations prohibit their members from accepting payment for fundraising activities based on a percentage of the amount of charitable income raised or expected to be raised. For these reasons, **[Insert name of the nonprofit]** does not compensate internal or external fundraisers based on a commission or a percentage of the amount raised.

5. **<u>Charitable Solicitation Laws</u>:** Most states, including Pennsylvania, regulate the solicitation of contributions by charitable organizations. To solicit funds in the Pennsylvania and various states, a nonprofit must register with the local government. Therefore, unless it qualifies for an exemption, **[Insert name of the nonprofit]** is required to register with the Pennsylvania government and with each state where it solicits funds from individuals, foundations, or businesses located in that state. The Board is responsible for ensuring that **[Insert name of the nonprofit]** complies with the various charitable solicitation laws.

6. **<u>Privacy Policy</u>: [Insert name of the nonprofit]** respects the privacy of individual donors and, except where disclosure is required by law, does not sell or otherwise make available the names and contact information of its donors without providing them an opportunity at least once a year to opt out of the use of their names.

C. <u>Board Participation:</u> In addition to the preceding tasks, each member of the Board should show his or her personal financial support for the organization. Many directors contribute to their organizations in ways other than financial, such as having an understanding of the community in need or having prior nonprofit experience. Directors also offer specialized skills such as human resources or financial expertise. The organization cannot succeed without those contributions.

However, we cannot expect others to financially support **[Insert name of nonprofit**] if the Board does not. Your personal participation is essential to a successful fundraising campaign. **[Insert name of nonprofit]** does **not** expect its directors to donate a minimum dollar amount to the organization. However, **[Insert name of nonprofit]** does ask you to contribute to the organization's annual fundraising campaign. **[Insert name of nonprofit]**'s goal is to have 100 percent participation by the Board.

In addition, you should help management identify and evaluate prospective donors, including individuals, corporations, and foundations. As a director, you should also assist in cultivating prospective donors by stimulating interest in **[Insert name of nonprofit]** and its work.

4. Board's Responsibility for Financial Oversight

Because **[Insert name of nonprofit]** is fortunate that so many people support the organization by giving their time and money—often at great sacrifice to themselves—it is important that **[Insert name of nonprofit]** exercise good stewardship in managing the donations of its supporters.

The senior management of **[Insert name of nonprofit]** plays a key role in managing the financial affairs of the organization, but the Board is ultimately responsible for ensuring that its funds are properly utilized.

Over the past several years, the IRS has increased its financial oversight of nonprofit organizations. Several states also have started extending these governance principles, previously applicable only to public companies, to cover nonprofit organizations. Moreover, grant makers and other donors expect nonprofit organizations to exercise robust financial oversight. Therefore, the Board should establish clear policies and procedures to protect **[Insert name of nonprofit]**'s financial assets and ensure that it is following best practices.

As a director, you can call on the **[Insert name of nonprofit]**'s resources, including senior management and the independent auditors responsible for conducting the organization's annual audit, to help you perform your duties. In particular, the Board, or a designated committee of the Board, should meet with the auditors before the annual audit and after a draft audit is prepared to discuss the auditors' findings and to determine what steps, if any, the Board should take to improve the financial oversight of the organization.

The following is a summary of the key financial responsibilities of the Board:

A. **<u>Policies and Procedures:</u>** While it is management's responsibility to oversee the day-to-day accounting and financial management of **[Insert name of nonprofit]**, the Board is responsible for ensuring that proper financial systems and controls are in place. For example, the Board should establish a policy to ensure that at least two unrelated people (either staff members or volunteers) bear the responsibility for receiving, depositing, and spending the organization's funds. The Board is also responsible for reviewing practices and reports to ensure that staff members and volunteers are complying with Board-approved policies.

B. **Budget and Expenses:** The Board is responsible for reviewing and approving the **[Insert name of nonprofit]**'s annual budget. The Board should also receive regular financial reports, either monthly or quarterly. The reports should show budgeted and actual expenditures as well as budgeted and actual revenues. By carefully reviewing the regular financial reports, the Board will be able to determine whether adjustments must be made in spending to accommodate changes in revenues.

However, prudent financial oversight requires that the Board look beyond monthly or annual financial reports to consider how **[Insert name of nonprofit]**'s current financial performance compares with that of previous years, and how its financial future appears. If **[Insert name of nonprofit]**'s net assets have been declining over a period of years, or if future funding seems likely to decrease significantly, the Board may need to take proper steps to achieve or maintain the financial stability of the organization.

C. **Prudent Investment of Financial Assets:** As a member of the Board, you also have the obligation to establish policies and procedures to ensure that **[Insert name of nonprofit]** manages and invests its funds responsibly and in compliance with the legal requirements. The Board is responsible for establishing policies that govern how the funds will be invested, ensuring that donor-restricted funds are used in a manner that complies with the donor's restrictions, and allocating the returns from investments among the various programs. For example, the Board must decide questions such as:

- Will **[Insert name of nonprofit]** maintain an endowment where funds that may be used to serve its purpose may be restricted by the donor?
- How much of an operating reserve should the organization have (i.e., three months of operating expenses)? Under what circumstances can the operating reserve be used? Who makes the decision to use the operating reserve?
- Are there any restrictions in how **[Insert name of nonprofit]** will invest its funds? For example, does **[Insert name of nonprofit]** wish to invest in the stock of companies that manufacture armaments or alcohol, maintain gaming establishments, etc.?

As a member of the Board of Directors, you are expected to carry out your responsibility to manage the funds of the organization in good faith, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. This means that you are responsible for overseeing the investment of the funds to ensure that those charged with making the investment decisions, including any committee appointed by the Board, are acting prudently. As a director, you should keep in mind several factors in carrying out these duties, among which are:

- The needs of the organization and the general economic conditions, including the possible effects of inflation and deflation;
- The expected total return for an investment, including appreciation, and how that plays within the overall investment portfolio;
- The need to preserve capital versus the need to generate income;
- The other resources available to **[Insert name of nonprofit]**;
- An asset's special value, if any, to the organization; and
- Any expected tax consequences with respect to an investment.

In managing the funds, the Board may incur appropriate costs that are reasonable in relation to the amount of assets being invested and the purposes of **[Insert name of nonprofit].**

By following these steps, you will help ensure that **[Insert name of nonprofit]** acts as a good steward of its funds and in a manner that helps the organization carry out its mission.

5. Strategic Planning

Another important task that the Board must undertake is to set the strategic direction of **[Insert name of nonprofit]**. The Board has the primary responsibility of carrying out this task, with the help of senior management, to ensure the future sustainability and growth of **[Insert name of nonprofit]**. Therefore, it is important that the Board take time every three to five years to develop a long-term plan for the organization.

The starting point of any strategic plan is **[Insert name of nonprofit]**'s mission statement. Both the Board and senior management must have a good understanding of the organization's mission and how **[Insert name of nonprofit]**'s current activities serve that mission.

- *Case Study: ABC Organization is a nonprofit that was established in 1885. Its mission, as set forth in its by-laws, is to help Eastern European immigrants and their descendants living in Metro City adjust to life in the United States. To achieve its mission, ABC has provided English language classes, job training, citizenship training, and adult education. It also provides financial assistance to immigrants in need. To house the organization, ABC purchased a* *building in 1925 in the Jonesville neighborhood where the Eastern European community was concentrated.*

Next, the Board must have a good understanding of the interests and concerns of **[Insert name of nonprofit]**'s various stakeholders. What resources exist to meet the needs of the community it intends to serve, and what needs have not been met? The Board should then determine whether the activities the organization engages in, or may want to engage in the future, are:

- Consistent with its mission; and
- Designed to meet its client community's current needs.

> *The Eastern European immigrant population in Metro City has shrunk because of changes in U.S. immigration policy restricting new immigration and the aging of the existing immigrant community. The Eastern European population now consists primarily of second- and third-generation European-Americans who were born in the United States, speak English as their first language, and are economically middle-class. Most of the target population no longer lives in the Jonesville neighborhood, but in the suburbs. The Jonesville neighborhood is now made up primarily of newly arrived Hispanic immigrants.*

Third, the Board should determine whether **[Insert name of nonprofit]**'s existing programs are also effective in carrying out its mission. Is the organization meeting the goals it set out to achieve? Are there more effective ways to achieve its mission? Does **[Insert name of nonprofit]** have to shift the focus of its mission to meet current or future stakeholder needs?

> *Over the years, the demand for ABC's services has decreased significantly. Its English language classes are sparsely attended. It receives few requests for financial assistance, and these requests are primarily from the few elderly immigrants still living in Jonesville. Few of ABC's target population want to attend the job training and adult education classes because ABC's headquarters are located miles from where they live.*

Finally, the Board should evaluate what resources are available to **[Insert name of nonprofit]** that would allow it to undertake the activities the Board has identified to help meet the needs of its stakeholders or expand its services.

> *Most of the funding available to serve immigrant communities in Metro City is targeted for the rapidly increasing Hispanic population. There are fewer funders to which ABC can apply for funds.*

Once the Board has evaluated **[Insert name of nonprofit]**'s current activities against the mission statement, taken stock of the needs of its stakeholders, and determined what resources are available to assist the organization in carrying out its mission, the Board, working closely with senior management, must develop a strategic plan for **[Insert name of nonprofit]**. The plan will then serve as a basis for determining **[Insert name of nonprofit]**'s activities and initiatives from year to year. It will help the Board and staff evaluate new opportunities as they arise, to see if they are consistent with the direction the Board and management want to take the organization.

- *To meet the changing conditions, ABC adopts a strategic plan that calls on it to expand its mission to serve all immigrant populations in the Jonesville neighborhood, and will no longer target only Eastern European immigrants and their descendants for its services. As part of the plan, it will reach out to the Hispanic community and tailor its programs to meet the community's unique needs. ABC will also consult with its legal counsel to determine what changes, if any, it needs to make to its organizational documents to reflect its expanded mission. ABC's legal counsel also will review any funding ABC has received in the past to see if there are any limitations on its ability to use the funds for the expanded part of its mission.*

Once the Board has adopted the strategic plan, senior management is responsible for developing an annual work plan that implements the goals in the strategic plan. The Board will then measure the progress toward the strategic plan's goals on an annual basis.

6. Overseeing the Performance and Compensation of Management

The **[chief paid staff member]** of **[Insert name of nonprofit]** is the chief executive of the organization and is hired and supervised by the Board. The Board also has the authority to fire the **[chief paid staff member]** if he or she is not meeting the performance standards set by the Board.

As part of its responsibilities, the Board should review the performance of the **[chief paid staff member]** annually. By giving the **[chief paid staff member]** feedback at least annually, the Board will assist the **[chief paid staff member]** in performing to the best of his or her abilities.

The Board is also responsible for setting the compensation for the **[chief paid staff member]** and other members of senior management. The Internal Revenue Code sets forth the criteria for determining who is a member of senior management, and provides that a nonprofit organization cannot pay more than "reasonable" compensation to its senior managers. Moreover, the Internal Revenue Code imposes penalties if excess compensation is paid.

The good news is that **[Insert name of nonprofit]** and its Board can significantly reduce the risk of paying compensation to senior management that will be considered excessive compensation. The Internal Revenue Code provides a three-step process which, if followed by the Board, will result in the IRS presuming that the compensation set by the Board is reasonable. The three steps are:

1. The compensation level must be approved by the Board or a committee of the Board authorized by it to set the compensation;
2. The Board makes use of data showing how much similar organizations are paying their employees to determine that the compensation is reasonable; and
3. There is proper documentation of the decision-making process.

A. <u>Prior Approval by Authorized Body:</u> To satisfy the first requirement, either the Board or a Board committee authorized by the Board to determine senior management's compensation must approve the compensation package **in advance**.

To participate in the compensation approval process, a director cannot have a conflict of interest. If you, as a director, have a conflict of interest, you must disclose your conflict to the other members of the Board, and you may not participate in the vote or discussions of management compensation.

The following are the principal rules for determining whether a conflict of interest exists, with examples of how those rules would apply:

- A conflict of interest exists if you are participating in or economically benefiting from the compensation arrangement being voted on, or you have a family member benefiting from the compensation arrangement.

  ➢ *Example: You are the parent of the* **[chief financial officer]**. *You may not vote on the* **[chief financial officer]***'s compensation because you would be voting on a compensation arrangement from which a family member of yours would be benefiting.*

- A conflict of interest exists if you are an employee subject to the direction or control of a member of management whose compensation is being voted on.

  ➢ *Example: You are an employee of* **[Insert name of nonprofit]** *and report to the* **[chief paid staff member]**. *You may not vote on the* **[chief paid staff member]***'s compensation package because your vote may be influenced by your desire to help your career.*

- A conflict of interest exists if you receive compensation or other payments that must be approved by a member of management whose compensation is being voted on.

  - *Example:* **[Insert name of nonprofit]** *retains your services as a fundraising consultant. The chief financial officer approves the payments and reimbursement of expenses to you. Again, you may not vote on the* **[chief financial officer]***'s compensation package because your vote may be influenced by your desire to help your career.*

- A conflict of interest exists if you have a material financial interest that would be affected by the compensation package being voted on.

  - *Example: The* **[chief paid staff member]** *owes you money and is having trouble paying it back. You may not vote on the* **[chief paid staff member]***'s compensation package because your vote may be influenced by your desire to recover the amount you are owed by the* **[chief paid staff member]**.

- A conflict of interest exists if you vote on a compensation package for a member of management, and that member of management has approved, or will approve, a transaction providing economic benefits to you.

  - *Example: The* **[chief paid staff member]** *sits on the Board of a nonprofit that employs your spouse. As a member of that Board, the* **[chief paid staff member]** *would be expected to vote on your spouse's compensation package. As a member of* **[Insert name of nonprofit]***'s Board, you may not vote on the* **[chief paid staff member]***'s compensation package because your vote may be influenced by your desire to increase your spouse's compensation, which will provide an economic benefit to you as well.* (For the same reason, the **[chief paid staff member]** should refrain from voting on your spouse's compensation package at the other organization.)

Family members include your spouse, parents, siblings and their spouses, children and their spouses, and grandparents, great grandparents, grandchildren, and great grandchildren and their spouses.

B. **Use of Appropriate Comparability Data:** Prior to voting on senior management's compensation, the Board must determine how the proposed compensation package compares to compensation paid by similar organizations for similar services. Comparability data is appropriate if it provides the Board with sufficient information to determine if the compensation arrangement, in its entirety, is reasonable when compared to what other organizations pay.

The information the Board may use to make the comparability determination includes:

- The actual compensation paid by similarly situated for-profit and nonprofit organizations for comparable positions;
- Whether or not there is a ready supply of people to perform similar services in the Washington, D.C., area;
- Current compensation surveys compiled by independent firms; and
- Actual written offers from similar institutions competing for the services of the senior manager.

There are a number of ways to obtain comparability data. **[Insert name of nonprofit]** may hire a compensation consultant to review **[Insert name of nonprofit]**'s compensation structure. However, if the Board feels that this is too costly, the Board can purchase compensation comparability data from organizations that provide technical assistance to other nonprofits or from human resource companies that compile that information for a fee. As a third alternative, the organization can use publicly available information on Web sites such as www.guidestar.org to determine what comparable organizations are paying their employees. As a starting point, it is good for the Board to define what are **[Insert name of nonprofit]**'s "peer" organizations for purposes of making comparisons.

If **[Insert name of nonprofit]**'s annual gross receipts are less than $1 million during the three years before the Board sets senior management's compensation, the IRS provides that **[Insert name of nonprofit]** may look at compensation paid by three comparable organizations located in Pennsylvania, or a similar community for similar categories of employees for purposes of determining comparability.

C. Proper Documentation of the Decision-Making Process: The third part of the IRS procedure for setting management compensation is to ensure that the Board's decision-making process is properly documented. The documentation may be written or electronic such as written minutes or an e-mail summary of the meeting. The documentation must note:

- The terms of the compensation package and the date it was approved;
- The members of the Board or Board committee who were present when the compensation package was debated, and those who voted on it;
- The comparability data obtained and relied on by the members of the Board and information on how the data was obtained; and
- Any actions taken by a regular member of the authorized body who had a conflict of interest with respect to the transaction (e.g., did the member leave the meeting and refrain from taking part in the decision?).

The documentation must be completed in a timely manner. This means that **[Insert name of nonprofit]** must prepare the records before the later of:

- The next meeting of the Board or committee, or
- Sixty days after the final action or actions are taken.

Also, the Board or committee must review the documentation and make any needed corrections to the documentation within a reasonable amount of time.

- *Example: The Board approves* **[chief paid staff member]***'s compensation package on December 1. The minutes of the meeting must be prepared and distributed to the Board for its approval at the next Board meeting. However, if the next meeting is held sooner than 60 days after December 1, the Board has until 60 days following the meeting, or January 30 to approve the minutes.*

[Insert name of nonprofit] has to comply with all three steps to establish the rebuttable presumption of reasonableness. The **[Insert name of nonprofit]** will not enjoy the protections the safe harbor affords if the organization fails to meet any one of these three requirements. Establishing the rebuttable presumption of reasonableness is also considered to be a "best practice" in terms of nonprofit governance. The IRS will ask **[Insert name of nonprofit]** to disclose the method it used to set management's compensation when it completes its IRS Form 990. Also, **[Insert name of nonprofit]** must appropriately report the compensation in its tax filings, both on the organization's annual IRS Form 990, and on an IRS Form W-2 issued to the recipient of the compensation (if he or she is an employee) or IRS Form 1099 (if he or she is an independent contractor).

7. Risk Management

A. Liability of the Organization: One of the functions of the Board is to protect the assets of **[Insert name of nonprofit]**. This will help ensure that the assets are available to serve the mission of the organization. To do so, the Board should implement an appropriate risk management plan.

There are three basic steps in any risk management plan. They are:

1. Identify the risk;
2. Mitigate the risk; and
3. Insure against the risk

The Board should begin by working with management to identify activities that create risks for the organization. The next step is to see if there are any procedures the organization can take to lessen the risk that a bad event will occur. The final step is to work with **[Insert name of nonprofit]**'s insurance broker to see if there is any way the organization can insure against the risk that such bad event occurs.

The following are some examples of how this process works:

- **[Insert name of nonprofit]** *regularly receives invoices from various people with which it does business. It is the employees' responsibility to pay* **[Insert name of nonprofit]***'s invoices.*

  1. Identify the risk.

  There is a risk to the organization that an employee could steal **[Insert name of nonprofit]***'s funds. The employee could pretend to pay invoices by writing checks to a friend or relative.*

  2. Mitigate the risk.

  The Board and management adopt financial controls which provide that there must be two signatures on all checks above a specified amount, such as $500.

  3. Insure against the risk.

  [Insert name of nonprofit] *purchases employee dishonesty coverage as an endorsement to its property insurance policy. This insures* **[Insert name of nonprofit]** *against loss, up to a specific dollar amount (for example $10,000), in case an employee steals funds from the organization.*

- **[Insert name of nonprofit]** *holds an annual car wash as a fundraiser.*

  1. Identify the risk.

  There is a risk to the organization that a volunteer will slip and fall at the car wash, injuring him- or herself.

2. Mitigate the risk.

[Insert name of nonprofit] *adopts safety procedures for conducting the car wash. The organization also asks each volunteer to sign a waiver of liability.*

3. Insure against the risk.

[Insert name of nonprofit] *purchases volunteer accident insurance. This insurance pays a volunteer's uninsured medical expenses, up to a specific dollar limit (for example $25,000), on a no-fault basis.* **[Insert name of nonprofit]** *also purchases general liability insurance to protect the organization in case it is sued by the injured volunteer for compensation for the injury.*

B. Liability as a Director: As a director, you may be subject to a lawsuit if someone alleges that you failed to carry out your duties appropriately, or you were guilty of discrimination in connection with someone's employment or the provision of nonprofit services. To protect yourself from liability, you should consider three steps:

1. **Prevention:** Exercise your duties as a director with due care and ensure that **[Insert name of nonprofit]** acts in accordance with legal requirements. This is the best way to avoid liability. If you carry out your duties as a director diligently and with due care, you will be much less likely to encounter legal problems.

2. **Indemnification:** One way to protect yourself against liability is to ensure that **[Insert name of nonprofit]** will pay any attorney's fees you incur and any legal damages you have to pay in connection with any acts you commit while serving on the Board. This is called "indemnification." Indemnification provisions are found in **[Insert name of nonprofit]**'s by-laws. You should consult with **[Insert name of nonprofit]**'s attorney to determine whether you would be covered by **[Insert name of nonprofit]**'s indemnification. In general, you will be eligible for indemnification as long as you acted in good faith and in the best interests of the organization.

3. **Directors' and Officers' Insurance:** Another alternative is for the organization to purchase Directors' and Officers' Liability Insurance (D&O insurance).Under most D&O insurance, you will be reimbursed for your legal defense costs if you are sued, and the insurance will pay any settlement for claims covered by the policy, subject to any exclusions in the policy. Some insurance policies stipulate that the insurance company will provide you with a defense if you are sued. This prevents you from having to pay your

attorney's fees and wait for reimbursement. **[Insert name of nonprofit] maintains D&O insurance with [Insert name of insurance carrier] in the amount of $____________. You should consult with our insurance broker if you have any questions about this type of insurance.**

8. Board Evaluation

The final task the Board must undertake is to periodically evaluate its own performance. Self-evaluation can be hard. Therefore, the Board should at least use a performance checklist to assist the members *(see Appendix Q).* Some of the criteria are objective and easy to evaluate such as attendance at meetings. Other criteria are more subjective.

However, it is important for the Board to meet annually to discuss how it can improve its performance. The Board should determine what skills the Board may be lacking, and whether it can recruit a new member with those skills. For example, is there a member of the Board with a background in finance, human resources, or the law?

Moreover, each director must be engaged in the work of the Board. If the directors are not fully engaged in the Board's work, the Board should discuss what steps it should take to re-engage its members. Without a fully engaged Board, there is a likelihood that the work will fall on a few individuals. This will not only result in many tasks not being done, but will also put members of the Board who are most engaged at risk of becoming burned out.

If efforts to re-engage a director do not work, the Board should be willing to ask the director with poor performance to resign from the Board, or to leave the Board at the end of his or her term. While evaluating the performance of individual members can be hard, it is important to remember that the Board's first duty is to serve the best interests of **[Insert name of nonprofit]** and not those of other members of the Board. Building a strong Board makes the Board's workload more manageable and improves the performance of each member of the Board of Directors.

Conclusion

Again, we want to express our appreciation of your willingness to serve as a director of **[Insert name of nonprofit]**. There are many exciting challenges ahead, and we are grateful that you have accepted the responsibility of being a member of the Board.

As an organization, we are committed to giving you the resources you need to succeed. Also, we realize that as a new member, you have a background that is different from members of the Board who have served longer. Your presence enriches and renews the Board. Much of the information in this manual may seem overwhelming at first, but if you have any questions or if there is anything **[Insert name of nonprofit]** can do to assist you in your Board service, please speak to the officers of the Board or senior management.

We serve an important mission, and we believe that you will find serving on the Board a rich and rewarding experience. Thank you for joining us.