KNOW AND GROW

FIDUCIARY DUTIES AND BEST PRACTICES FOR NONPROFIT DIRECTORS

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Serving on a nonprofit organization's board of directors[1] can be exciting – and daunting. If you have accepted this challenge, it is likely you have a strong interest in the organization's mission and purposes. It is also likely that you may be passionate about what the organization can accomplish or the social issues it tackles. You believe you can make a difference. You want to give back to the community. You desire to change the world for the better.

Even with the most altruistic intentions, individuals who agree to serve on non-profit boards often fail to fully understand their director responsibilities and legal duties. Many new directors are frequently surprised to learn that the board, collectively, is *the* central decision-making body for the organization and is accountable for the organization's actions and financial health.

This paper discusses the fiduciary duties of a board director, outlines director's responsibilities along with best practices, and provides considerations to help you evaluate the myriad decisions that nonprofit board directors must make. Understanding and embracing these tenets is the first step in becoming a successful leader and board member.

Increasingly, charitable organizations' public image and reputation are influenced by its leaders' integrity and strength. Well-run nonprofits have directors who hold the organization's mission in high regard, who understand and faithfully execute their duties and make strategic decisions supporting the organization's overall well-being. Here's how to be one of them.

FIDUCIARY DUTIES

When you agree to serve on a nonprofit organization's board, you assume a series of fiduciary[2] duties (legal obligations) on its behalf. Nonprofit organization's directors are responsible for managing the organization's charitable assets, which, by nature, are for the benefit of the public—not private interests or individuals. The use and care for these charitable assets are overseen by:

- The Internal Revenue Code's (IRC) laws and regulations governing the organization's federal tax-exempt designation type;[3]
- State statutes, regulations and common laws usually enforced by the state attorney general's office; and
- Other governmental authorities.

A director is obligated to fulfill three primary fiduciary duties – loyalty, care and obedience. A fourth fiduciary duty is recordkeeping.[4] These fiduciary duties, with the exception of obedience, are modeled after the for-profit sector and the fiduciary duties for directors serving on for-profit boards. The duty of obedience is unique to directors serving on nonprofit boards. Whether for-profit or nonprofit, these fiduciary duties provide the financial and corporate governance framework under which directors should adhere to while serving on a board.

Duty of Loyalty

Under the duty of loyalty, directors are expected to act in the nonprofit's best interest, not in their own. The duty of loyalty creates a relationship of trust between the director and the organization. As such, a director cannot use that relationship to benefit herself, family members, friends or other interested parties. Other interested parties may include a for-profit corporation in which a family member has a significant ownership stake and this corporation conducts business with the nonprofit organization. It is not uncommon for a director to have many external business and professional connections that may prove useful to some aspect of the organization's needs. Directors must ensure, however, that when their personal business and professional connections intersect with their director role, their loyalty to the nonprofit organization is prioritized.

Conflict of Interest. A conflict of interest may arise when a director receives an improper personal benefit from a transaction involving the organization's assets. A director's conflict of interest, however, may not always be improper or constitute a violation of the duty of loyalty. An engaged board of directors can take steps to address potential conflicts to maintain the organization's best interests and avoid a breach of a director's duty of loyalty.

The following illustrates how a director's conflict of interest can occur along with action steps the board and the director may take to resolve the conflict.

> *Ellison's Food Pantry needs to upgrade its information technology (IT) system. One of the directors' daughters owns an IT business and is interested in completing the upgrade. In addition, the director owns a 30% interest in his daughter's business. Since both the director and his daughter could receive a direct financial benefit if the daughter receives the job to upgrade the IT system, there is conflict of interest. If the director wants Ellison's board to hire his daughter's company, the director and board should undertake these steps:*
>
> - *The director should disclose his interest in the company and his familial relationship with the owner;*
> - *The board should seek proposals from the daughter's business and other businesses qualified to conduct the same work;*
> - *In reviewing the proposals the board should not only consider the cost but also the quality of work, timeliness and dependability;*
> - *In considering all the proposals, the director with the conflict must not participate in the board's decision process for the hire; and*
> - *The director's recusal from the decision should be reflected in the board minutes.*

A Nonprofit's Key Differentiator

With the signing of the Tax Cuts and Jobs Act on December 22, 2017, many nonprofit sector experts have speculated that contributions to charitable causes could fall significantly in 2018 and beyond.[2] Conversely, other experts believe the lower tax rates may result in more charitable contributions as individuals find themselves paying less in taxes and retaining more income. In either case, and given the sheer number of public charities and competing causes, donors and philanthropists may become much more discerning when considering charitable causes and organizations to support. For many donors, determining whether an organization is well-run and worthy of public support may rest entirely on how well the organization's directors manage risk, oversee its mission and programs, and how adeptly the organization manages its financial resources.

A Director's Fiduciary Duties

- Loyalty
- Care
- Obedience
- Recordkeeping

By taking these steps, the board helps ensure a potentially improper conflict of interest is averted and the nonprofit organization's best interests are taken into account, even if the director's daughter's business is ultimately selected to perform the IT upgrade.

Conflicts of interest can also arise when a nonprofit organization loans money to a director. In general, nonprofit directors do not have the power to approve the lending of nonprofit assets to themselves. Some states permit such loans if the terms of the loan coincide with the terms of current commercial loans, the nonprofit has addressed and documented the conflict of interest, and the loan does not violate the fiduciary duty of care, which will be discussed later.

To protect both themselves and their directors, the board should maintain a conflict of interest policy requiring all directors to complete a conflict of interest disclosure form annually. By doing so, the nonprofit organization will have an established process for directors to disclose potential conflicts of interests and for the board to address such conflicts. Following these procedures, and making sure that conflicts of interest are appropriately reflected in board minutes, ensures that the organization has sufficient evidence to minimize or prevent potential accusations by donors, employees or the state attorney general's office of improper conflicts of interest.

Exploitation of the nonprofit organization's information, property or opportunities. In the course of service on a nonprofit board, a director will invariably learn unique and confidential information about the organization. A director is bound by the duty of loyalty to not use that information for personal benefit to the detriment of the nonprofit.

A director who serves on the board of a large nonprofit organization that holds significant real estate interests must not use financial and other knowledge of particular transactions between the organization and a third party for her personal benefit. For example, a university board member who learns a proposed acquisition was rescinded due to environmental concerns that arose during a Phase I Environmental Study, cannot later use that information to purchase that property at a lower price, whether as an individual, through a business or as a silent investor.

Intellectual property is another source of confidential information that nonprofit directors must not use for personal benefit. This can include donor lists or, in the case of hospitals, highly complex medical procedures. Sometimes identifying an organization's intellectual property may not be so clear to the nonprofit or even the individual responsible for creating it. For example, consider the following.

Laura's Hope is an organization that raises money for combatting severe or terminal illnesses. Laura's fundraising and program activities include live music and other multimedia, music-related events. For an upcoming live music charity event, a staff member writes and scores an original composition to be played at the event. The staff member does not take any steps to license the work in her name or in the name of Laura's. During a rehearsal, a director, who is also a musician, records the composition and later makes his own licensed version of the work that he attempts to sell for commercial

A director can be in breach of fiduciary duty of loyalty:

1. When the organization conducts a transaction in which a director has a conflict of interest;
2. By exploiting the organization's information, property or opportunities for private benefits; or
3. By misusing the organization's assets or resources.

gain. In this instance, the director has used confidential, intellectual property developed for a fundraising event for his personal economic gain. Nonprofits that own significant intellectual property should require their directors and employees to sign confidentiality and non-disclosure agreements to prevent these kinds of situations.

Misuse of the organization's assets or resources. When it comes to misuse of a nonprofit organization's assets, rarely does a director breach her duty of loyalty through outright theft. Rather, the breach of loyalty occurs when a director uses her influential position to access the organization's assets or resources for personal benefit or gain. This includes reserving equipment or space for activities for personal business, using vehicles or other forms of transportation owned by the nonprofit organization for personal business, or submitting requests and receiving reimbursement for lunches or other activities unrelated to the organization's mission. In each of these cases, the Internal Revenue Service, may find these uses constitute improper private benefit to the offending director or employee in violation of IRC § 501(c)(3). If the IRS finds violations, they have a number of penalties ranging from imposition of excise taxes to revocation of the organization's tax-exempt status.

QUESTIONS FOR CONSIDERATION

- Does your organization have the proper policies and procedures in place to address conflicts of interest?
- How will you deal with perceived conflicts of interest versus real ones?
- How is your nonprofit safeguarding its confidential information and intellectual property?
- Do you have your directors and employees sign confidentiality and nondisclosure agreements?
- Does your organization have policies addressing compensation, travel and reimbursement, and use of the nonprofit's resources by directors and employees?

Directors of nonprofit organizations may also find themselves subject to IRS tax penalties through IRC § 4958—"Taxes on excess benefit transactions." Taxes on excess benefit transactions (EBTs) are triggered when a "disqualified person"[5]—a term that includes directors, officers and other foundation managers—accepts or permits an improper private benefit. While EBTs are based on individual facts and circumstances, EBTs often relate to excessive compensation, reimbursements and loans. With respect to a nonprofit organization's reimbursement payment, if an organization does not have a written reimbursement policy and procedure in place but reimburses disqualified persons for legitimate business expenses, the IRS will consider any reimbursement payments to directors as automatic EBTs.[6]

Because EBTs are a big concern for the IRS, nonprofit organizations must disclose any EBTs on its annual Form 990 tax return. Penalties for EBTs can be severe. If a director commits an EBT, the director must pay the amount of the EBT and can be penalized up to 225% of the EBT. (Note that the 25% penalty cannot be waived for reasonable cause, although the 200% penalty can be avoided by

Key Organizing Documents and Policies

- IRS Form 1023 - This document, which was submitted to the IRS when the organization sought to obtain its tax-exempt status, likely contains the mission statement and purposes of the organization
- Articles of Incorporation, including all amendments
- Bylaws
- IRS Form 990 (annual tax filing)
- List of board committees, committee responsibilities and board rosters
- Board policies, including but not limited to: conflict of interest; whistleblower; document retention; endowment; gift acceptance; spending; investment; restricted gifts; joint ventures; social media
- Directors and officers liability insurance policy and other insurance coverage for the organization
- Audited financial statements

prompt correction of the EBT upon notice from the IRS.) In addition, directors who approved the improper transaction or payment is personally liable for an excise tax of 10% (the penalty is capped at $20,000). The organization cannot pay the director's personal EBT penalties; the director bears the liability individually. The director also may be subject to separate state penalties.

Duty of Care

The duty of care requires that directors use due diligence, care and skill in fulfilling their board responsibilities. To properly exercise their duty of care, directors should:

- Understand the organization's foundational documents (*i.e.*, bylaws, articles of incorporation, trust agreements, indentures);
- Stay informed of its activities and programs;
- Attend board meetings regularly;
- Make informed decisions concerning the use of the organization's assets; and
- Maintain a familiarity of its current policies and procedures.

When directors encounter matters beyond their areas of expertise, they should seek outside experts to help the board make informed decisions. If a complex transaction goes awry and litigation ensues, directors may be held liable for failing to seek third-party expertise and advice. In most states, nonprofit directors are held to the business judgment rule or an equivalent standard, which gives directors wide latitude in their decision making. One area where directors do not have any latitude is with respect to paying state and federal payroll taxes. Directors with corporate signatory authority may be held personally liable for the organization's failure to collect these payroll taxes[7] and some states may also extend liability for failing to collect and remit sales tax and unemployment insurance contributions.

QUESTIONS FOR CONSIDERATION

- Before agreeing to serve on the board, did the organization provide a statement of board member expectations?
- Is there an onboarding process for new board members?
- Is there a committee that regularly informs the board of their legal obligations?
- Are board members instructed on their role as stewards of the nonprofit's charitable assets?

Directors are most frequently faced with duty of care issues relating to board participation and governance and managing charitable assets and resources. Active participation includes attending board meetings, participating on committees and helping ensure the board keeps proper minutes, resolutions and voting policies. Directors may not be able to shield themselves from liability by claiming they did not attend a particular board meeting when the matter at issue was addressed. In addition, if the board has adopted a new policy or resolution, the directors are responsible for helping ensure policy changes are implemented and communicated to appropriate staff. Board directors should also have familiarity with required federal, state and local tax obligations and filings, insurance coverage for the board and the organization, employer-employee obligations (especially employee handbooks) and environmental liability associated with buying and selling real estate, if applicable.

Nonprofit directors must also exercise exemplary stewardship of the organization's assets and resources. Most state laws stipulate that directors have a legal duty to supervise the nonprofit's charitable assets and ensure they are not wasted or used improperly. This applies not only to how the organization invests its assets, but also how it uses its space, equipment, vehicles and intellectual property. With respect to investments, directors must have a board-approved written investment policy and establish an investment committee, or hire outside investment professionals to manage the organization's financial portfolios.[8] The nonprofit's investment policy should not only include an asset allocation strategy that meets the nonprofit's long-term financial goals, but also take into account the organization's spending policy.

Duty of Obedience

While the duties of loyalty and care may be familiar to nonprofit directors who also have served as for-profit organization directors, they might not be familiar with the duty of obedience. Under this duty, directors must ensure the nonprofit adheres to its charitable mission and purposes. When an organization applies for IRS tax-exempt status, its purposes must align with its stated articles of incorporation or trust instrument or indenture, and be narrowly defined in order for the IRS to grant the exemption. A nonprofit that strays substantially from its mission and purposes will be required to modify its governing documents and notify the IRS of the changes in its exempt purpose. To safeguard the organization's mission and purposes, directors must be engaged enough to steer the nonprofit away from potentially competing or tangential interests. Two typical examples of directors violating their duty of obedience are engaging the organization's development staff to solicit donations for an activity outside the nonprofit's purposes, or funding initiatives or programs beyond the geographic scope of the organization's mission.

A nonprofit that strays substantially from its mission and purposes will be required to modify its governing documents and notify the IRS of its change in exempt purpose.

In some instances, a nonprofit's initial vision and purposes may evolve due to the passage of time, demographics and changed circumstances. When this occurs, directors should undergo a deliberative and strategic process to consider reframing the organization's mission and purposes. Any substantial changes may require the organization to update its by-laws and state incorporation documents, and notify the IRS.

RESPONSIBILITIES AND BEST PRACTICES FOR NONPROFIT BOARD DIRECTORS

In addition to the legal duties described earlier, every board member has four primary responsibilities:

1. Protect the organization's mission;
2. Ensure the organization's financial viability;
3. Govern and manage risk; and
4. Plan for leadership succession.

While the organization's management and implementation of strategy can be delegated to staff, these four responsibilities belong to the board alone.

Protect the Mission of the Organization

The organization's mission statement is the foundation for setting priorities, planning and decision-making. Essentially, it is the board's responsibility to translate the mission into goals and strategies that can be measured and achieved.

QUESTIONS FOR CONSIDERATION

- Is the organization's vision clear and compelling?
- Does the board put the interests of the organization before the interests of its members?
- Is the organization engaged in activities relevant to the community?
- If the organization's activities have strayed from its stated mission, has the board set a course to return to the mission or created a pathway to communicate its new purposes?
- Has the organization made clear statements to its donors and supporters about how the organization will employ resources?

Best Practices. It is a good practice for the board to review the nonprofit's mission statement on a periodic basis to make sure it accurately reflects the organization's activities, programs and purposes. These activities must continue to be relevant to the communities and constituents the organization serves. The board must also believe the goals set forth in the mission statement are achievable. For example, if an organization's mission is to reduce the number of homeless veterans in a specific community, and, as a result of the organization's activities, the number of homeless veterans has been reduced significantly, then perhaps the mission should evolve and a new purpose adopted. This new purpose might be to decrease the number of homeless children in that same community. If the organization's primary goal is to raise funds to build a healthcare facility and that has been achieved, the board might revise the mission statement and seek approval from donors to use any remaining funds to build an endowment to support the facility's maintenance.

The board must also help ensure the organization's activities and internal and external communications are closely aligned with its mission. The board or an appropriate committee should review the organization's solicitation materials to help ensure these documents are current, truthful and free of material false statements.

To help ensure directors are fully engaged as "mission ambassadors," board members should be encouraged to continually reflect on the mission and positive outcomes of the nonprofit's activities. Successful boards create opportunities at special retreats or board meetings for members to share inspiring stories about the organization's impact in their communities and with constituents. Starting every board meeting with a review of the organization's accomplishments (e.g., outcomes and social impact, new donors and strategic collaborations) since the last board meeting is a good way to keep the board focused on the organization's mission.

Only "giving time" is often inadequate to address a nonprofit organization's pressing financial needs.

Ensure Financial Viability

Arguably the most important role of a nonprofit's board is to ensure the organization's financial viability. This means the board is ultimately responsible for funding and resource development. Often a nonprofit organization fails to achieve its goals because the board has not fully embraced this critical role. Far too often, especially in the current environment, the demand for services provided by nonprofit organizations has outpaced available financial resources. When the declining rate of government support and donations corresponds with higher giving expectations from individual and corporate donors, even well-funded nonprofit organizations may not be able to survive or thrive.

While board members may not have primary responsibility for the day-to-day fundraising activities, many boards require its members to participate in fundraising, and to make personal donations. Delegating fundraising responsibilities to staff, or taking a "hands-off" approach to fundraising is not a sustainable practice. Similarly, only "giving time" is often inadequate to address an organization's financial needs.

Some fundraising experts have proposed that the responsibility of raising funds for the organization should be in the hands of experienced and trained staff. Indeed, board members may not find it easy or convenient to "ask" potential donors to make a contribution to the organization, even when those potential donors are friends or colleagues. Board members may lack fundraising experience even though they may have served on nonprofit boards in the past. And, it might be a mistake to assume a board member who is a successful corporate executive will be a good "closer" when it comes to securing charitable donations. There are, however, strategies and tactics that can be implemented and practiced to help ensure that every director can become a successful fundraiser. While fundraising can be difficult and may require a heightened commitment of time and energy, it should be empowering and energizing.

QUESTIONS FOR CONSIDERATION

- Are the fundraising goals for the organization and board members appropriate and achievable given immediate needs, short- and long-term goals and donor community trends?
- Have board members received training in fundraising strategies and tactics?
- Is the development staff equipped to train all board and committee members on the process of fundraising?
- Is there a process for holding board members accountable for fundraising and resource development?

Best Practices. Ultimately, if the board is to build a successful and financially viable organization, it must embrace and support what many development professionals refer to as a "culture of philanthropy." Board and staff members, and even donors, recognize philanthropy and fundraising are linked to the organization's financial and programmatic health and its ability to carry out its mission and purposes. All board members must embrace their role as organization ambassadors.

Fundraising activities and tactics may include galas, annual fund drives, benefit concerts, endowment campaigns, peer-to-peer and crowdfunding initiatives, grants and direct-mail donations. Any and all of these activities and tactics should necessarily flow from a board-approved fundraising strategy. This strategy should be informed by the organization's analysis of responses to the following questions: Where are we now? Where do we want to go? How are we going to get there? The strategy or plan should include, among other things:

- A designated coordinator, manager or champion;
- Specific expectations, goals and objectives tied to the organization's fiscal and outreach goals;
- A dependable administrative system;[9]
- A process for acknowledging and thanking donors and supporters; and
- A post-implementation evaluation and celebration.

While delegating the task of carrying out the strategy may be left to the development committee and staff, the board should be the principal architect of the strategy.

Fundraising expectations for board members should be clear, measurable and achievable. These expectations should be set by the board chairperson with recommendations from the development committee and staff, and based on the nonprofits' budgetary needs and the fundraising acumen and skills of each board member and the board, collectively. The board should adopt appropriate measures of success to ensure each board member is held accountable for reaching the organization's fundraising goals. For example, all board members should be expected to make substantial annual contributions to show their level

Nonprofit Board Members' Key Roles and Responsibilities

- Protect the organization's mission
- Set the organization's strategic direction and ensure effective operational planning
- Secure adequate resources for the organization and make a personal financial contribution, as needed
- Oversee organization's finances and investments, and develop and approve annual budget
- Evaluate and oversee executive director/CEO's performance
- Recommend, choose and provide training for future directors
- Serve on committees and stay informed about the organization's mission and activities
- Adhere to legal and ethical standards
- Approve and comply with major policies, specifically conflict of interest and confidentiality
- Be knowledgeable about the programs and services of the organization
- Serve as organization's ambassadors and external advocates

of commitment and build credibility with external donors. Board members also should be expected to cultivate relationships (with assistance from the organization's development staff) on behalf of the organization and participate in a specific number of fundraising tasks or events every year.

In addition, the board chairperson and the organization's CEO should identify or provide adequate training and opportunities for directors and development committee members so they will be empowered and effective in their roles as fundraisers and financial stewards. It is not uncommon for nonprofit organizations to send its board members to outside training or fundraising workshops to develop or enhance their fundraising skills.

Governance and Management

Directors of nonprofit organizations are responsible for the *governance* of the organization. *Governance* is quite different from *management*, which is generally the responsibility of the executive leadership team and staff, i.e., the CEO, COO, CFO and development director. Nonprofit governance is focused on the process for making and implementing decisions that will advance the organization's mission and provide strategic leadership for the organization.[10] This means the board is primarily responsible for the organization's acts and omissions and for providing sufficient oversight of any delegated activities.

In contrast, the role of management, usually led by the CEO or executive director, is to operate the organization in line with the board's direction and approval. Management makes operation decisions and policies, keeps the board educated and informed, and provides well-documented recommendations and information to support the board's policy-making, decision-making and oversight responsibilities.[11] Well-run nonprofit organizations have clearly-defined governance and management roles.

THE BOARD-MANAGEMENT RELATIONSHIP

Board's Roles	Management's Roles
Select, evaluate and support the CEO/executive director.	• Run the organization in line with board direction. • Keep the board educated and informed. • Seek the board's counsel.
Approve high-level organizational goals and policies.	• Recommend goals and policies, supported by background information.
Make major decisions.	• Frame decisions in the context of the mission and strategic vision, and provide well-documented recommendations.
Oversee management and organizational performance.	• Deliver timely information in concise, contextual, or comparative formats. • Communicate with candor and transparency. • Be responsive to requests for additional information.
Act as external advocates and diplomats in public policy, fundraising and stakeholder/community relations.	• Keep the board informed, deliver recommendations and mobilize directors to leverage external connections to support the organization.

From, *Distinguishing Governance from Management* by Barry S. Bader, Great Boards, Fall 2008, Vol. VIII, No. 3.

Depending on the nonprofit's organizational lifecycle, how long it has existed and the size of its staff, it may be necessary for the board to play a significant role in managing the organization's operations. Eventually, however, the board must evolve from an "operating board," where certain board members manage a few day-to-day activities, to one where governance is the primary function. In cases where the board must be involved in management – when board members must essentially "wear two hats" – it remains necessary for the directors to clearly define both roles.

Best Practices: Governance vs. Management. A best practice is for the board chairperson and the organization's executive leader to clearly define and separate governance activities from the staff's management and operational activities. It is important that board members and staff understand how they should work together. This will minimize confusion. For example, if the staff feels the board is micromanaging the organization, this can cause unnecessary confusion and tension and result in operational inefficiencies. At the same time, the staff should understand that its role is not to "run" the organization while the board sits on the sidelines or is minimally engaged.

Best Practices: Board Chairperson and Executive Director. The relationship between the board chairperson and executive director is one that requires care, clarity, trust and reciprocal communication. These two executives must have a common understanding of the organization's shared purposes and values. Between the board chairperson and the executive director, the roles and tasks include making sure:

- There are adequate oversight mechanisms, and
- The full board is kept apprised of the organization's financial picture.

These two leaders' ability to form a workable partnership and collaborative relationship to achieve these tasks may be the single-most important factor of a successful and sustainable organization. The board chairperson must empower the executive director and the entire executive leadership team to implement processes that will help ensure the organization's success.

Best Practices: Assessment and Evaluation. Another good practice is for the board to evaluate the organization's CEO/executive director's performance and set her compensation on an annual basis. This task should not be left to the board chairperson alone; rather, the entire board needs to be involved.

Successful boards will also assess the *board's* performance on a periodic basis. This is an opportunity for directors to reflect on whether the board is meeting its responsibilities to advance the organization's mission. Whether board members complete an anonymous survey or engage in one-on-one discussions with the chairperson, all board members should be given the opportunity to participate and provide candid feedback and responses regarding their individual and overall board performance. This is an especially important tool if the board wants to address leadership gaps, identify training opportunities and refine participation expectations.

Best Practices: Budget. Every year the entire board should approve the budget. Generally speaking, the finance committee is responsible for making sure the board has the information it needs to make decisions about the annual budget. Accurate financial reports, accounting and balance sheets are all appropriate documents for board members to review.

Best Practices: Onboarding Activities

Every board should develop and implement a robust orientation program that includes, but is not limited to:

- Introducing new board members to the organization's mission, values, programs, finances and constituents;
- Familiarizing board members with the organization's structure, procedures, operations, policies and staff roles;
- Clarifying expectations for board service (e.g., required time commitment, term limits, financial contribution minimums); and
- Pairing new board members with existing, experienced board members or former board members who can mentor the incoming directors.

As a best practice, the board should develop, maintain and update a board policy manual. This can be given to new board members and referenced by the board during meetings, if needed.

QUESTIONS FOR CONSIDERATION

- Do the organization's board members and key constituents have access to accurate and appropriate information regarding the nonprofit's financial records, internal operations and external results?
- Does each director have an opportunity to lend their skills and expertise to the board in a meaningful way?
- Does the board maintain a culture of respect and transparency where every board member feels comfortable sharing dissenting opinions and engaging in constructive conversations regarding the nonprofit's current and future direction?
- Are there opportunities for board members to improve and evaluate their performance?
- Has the board established mechanisms to support active and sufficient oversight of the organization's activities?
- Has the board engaged in strategic planning and established a structure upon which the plan can be efficiently executed?
- Is the board in compliance with local state and federal laws and rules and regulations relating to governance?
- Is the board aware of critical difficulties facing the CEO/executive director? Is there a constructive way to bring attention to these difficulties and help resolve potential problems?

Risk Management and Insurance

Any person considering serving on the board of a nonprofit should make sure the organization carries both general liability insurance and directors and officers (D&O) insurance. The organization's bylaws or trust instrument should contain indemnification provisions as well. These provisions aim to protect a director from lawsuits and any lawsuit expenses, so long as the director acted in good faith and in the organization's best interest.

Laws regarding the extent to which a nonprofit organization can indemnify its directors vary state by state and contain several exceptions. For example, directors cannot be indemnified if they have committed criminal acts or acts of gross negligence.

Under the Federal Volunteer Protection Act of 1997[12] (VPA), a volunteer director can be insulated from personal liability under certain conditions. The VPA will not protect volunteers who commit violent crimes, hate crimes, international terrorism, sexual offenses or civil rights violations. Also, the volunteer director must not have engaged in prohibited conduct (*e.g.*, gross negligence, willful or criminal misconduct, reckless misconduct) as described in the statute. Keep in mind, however, that even if a director is protected under the VPA, it does not prohibit a plaintiff's attorney from filing a lawsuit against the director. Though the VPA may provide some protection for a director, it should not be considered as an acceptable substitute for the organization carrying the appropriate D&O insurance. Because indemnification and insurance policies for nonprofit directors are complex, people thinking of serving on a nonprofit board should conduct their own due diligence on the organization's insurance and indemnification policies.

Plan for Succession

Helping ensure a good leadership succession plan is an ongoing challenge, especially for nonprofit organizations where board members are volunteers. Every board member should prioritize building a strong organization infrastructure and support the next generation of leaders, at the board level and among staff. In most cases, the board chairperson is uniquely suited to identify opportunities to recruit and train the organization's successors. However, this responsibility rests with the entire board.

QUESTIONS FOR CONSIDERATION

- Does the board composition reflect the organization's current constituents?
- Has the board identified prospective board members, volunteers, donors and advocates who can help the organization advance its mission?
- Does the organization maintain and periodically review board member, officer and committee member job descriptions?
- Are board membership and succession expectations clear and enforceable?

In general, state laws provide protection for volunteer board members, however these laws vary state-by-state and may contain important exceptions and nuances.

Best Practices. A useful succession planning tool might be to create a board profile grid. This grid will include a list of desired skills for board members based on the organization's current and future leadership needs. The board should also consider race/ethnicity, age and gender when creating a board profile grid. This list can then be used to acknowledge skills of the existing board members, identify those skills important to the organization's growth and sustainability, and support the board's recruiting and retention efforts.

Creating and adhering to board term limits is also an important way to help ensure new thoughts and new energy continually surround the organization's work. Instituting term limits allows for new board participation opportunities, alleviates seemingly intractable impasses on decision points and creates space for new and younger leaders to emerge.[13]

Many nonprofit organizations proactively create structures to ensure succession by supporting "junior" boards or committees where potential board members can learn more about the organization's priorities and witness good governance in action. Other organizations will intentionally set aside a certain number of board seats for potential "next generation" leaders to ensure continuing interest in the organization's work.[14]

CONCLUSION

Serving as a nonprofit organization board member can be demanding and time-consuming. Fortunately, there are many benefits and satisfying aspects, and you likely will be amazed by the good will generated by your commitment. Once you have become familiar with your roles and responsibilities, you will be able to lead by example and feel confident that the organization and its constituents will benefit from your diligence. Remember that good governance will always be the key to the organization's success and sustainability.

We hope these best practices and guidance will support the charitable work in which you are engaged, encourage your full participation as a nonprofit leader and provide direction and insights for your future endeavors.

RESOURCES

For an additional examination of the nonprofit board directors' roles and responsibilities, consult this list of resources.

- BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards*, 2005.
- BoardSource, *Step-by-Step: Recruitment and Orientation. A Four-Part System for Building Your Board*, 2003
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- Rick Moyers, The Nonprofit Chief Executive's Ten Basic Responsibilities, Second Edition, Board Source, 2012.
- Dave Sternberg, Fearless Fundraising for Nonprofit Boards, Second Edition, BoardSource, 2008.
- Mindy R. Wertheimer, PhD., The Board Chair Handbook, Third Edition, BoardSource, 2013.
- IRS Sample Conflict of Interest Policy can be found in Appendix A: https://www.irs.gov/instructions/i1023

ENDNOTES

1 In this paper, the term "nonprofit organization" refers collectively to public charities that are organized pursuant to the Internal Revenue Code (IRC) section 501(c)(3), endowments, foundations and other tax-exempt organizations that seek and rely on financial support from the public and to which individuals and corporations may make charitable contributions and claim a charitable contribution deduction on their federal income tax returns.

2 A fiduciary is "one who must exercise a high standard of care in managing another's property." Black's Law Dictionary, 11th Edition, Ed. Bryan A. Garner.

3 Examples of federal tax-exempt designations include a 501(c)(3) public charity, a 501(c)(3) private foundation, or a 501(c)(6) business league or trade association. For example, section 501(c)(6) of the IRC provides for the exemption of business leagues, chambers of commerce, real estate boards, boards of trade and professional football leagues, which are not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual. A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. Trade associations and professional associations are business leagues.

4 In short, the duty to maintain records requires directors to make sure the nonprofit maintains accurate financial and administrative records, including financial reports, annual budgets, payroll and employee personnel files, grant reports, and updated policies and procedures. While the duty to maintain records is important, the three fiduciary duties discussed above are the most important.

5 See IRC §4946 for the full definition of what constitutes a disqualified person.

6 See Lawrence M. Brauer and Leonard J. Henzke Jr., "Automatic" Excess Benefit Transactions under IRC §4958 (2004 EO CPE Text).

7 See IRC Sections §6321 and §6672. State laws regarding director liability for failure to remit payroll taxes varies by state.

8 For nonprofit private foundations established as trusts, the trustees (the director equivalent of a trust) may be held to the prudent investor rule, a more stringent standard that requires skill, reasonable care, and caution.

9 The board and staff should evaluate its existing fundraising infrastructure to determine whether the organization can adequately and successfully implement a fundraising strategy. For example, it is not uncommon for a nonprofit organization to have an inadequate donor management system which would make it difficult to prioritize direct donor solicitations.

10 To get a more comprehensive understanding of what governance is and best practices, see the following articles published by Nonprofit Quarterly: Nonprofit Governance and the Power of Things, Governance and Accountability: A Different Choice for Nonprofits; Exploring Emerging Forms of Nonprofit Governance; BoardSource's Board Governance Index: Is Your Board "Normal"?

11 Barry S, Bader, "Distinguishing Governance from Management," reprinted from Great Boards, Fall, 2008, Vol. VIII, No.3.

12 42 U.S.C. § 14501

13 There are some "board governance" experts, however, who suggest that term limits can be detrimental to nonprofit organizations because they may require boards to lose some of their best volunteer leaders.

14 Millennials represent 29% of the current U.S. population. Millennials are very philanthropically inclined and show great concern for the social, economic, and political issues affecting the world. For more information, please see: https://sobelcollc.com/sites/default/files/NFP%20Fall%202014%20Whitepaper.pdf.

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