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The Legal Responsibilities of Nonprofit Boards



March 13, 2008

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Scott Adams

“Informed decision-making comes from a long tradition of guessing and then blaming others for inadequate results.”

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Motivated to Manage Governance Risk

- **Fear of litigation**
 - Perception versus reality
- **Insurability**
- **Enlightened accountability**
 - Signal stakeholders
- **Doing the “right thing”**
 - Maximize mission



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Duty of Loyalty

- Requires that nonprofit boards:
 - make prudent decisions that will further the interests of the nonprofit,
 - always put the organization's interests above their personal interests when taking action or making decisions as the nonprofit's governing body.

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Duty of Loyalty: HOW?

- Choose board members who aren't prone to having personal interests that will be in conflict with organizational priorities:
 - staff members, family of staff members, large donors or staff of donor organizations
- Is this an all or nothing proposition?



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Duty of Loyalty: HOW?

- Make board members aware of conflict of interest procedures; and
- Implement a conflict of interest policy that includes annual, signed disclosure statements from board members.



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TOOLS: Conflict of Interest Policy

- What does such a policy require?
 - each board member must:
 - disclose actual, apparent or potential conflicts of interest
 - recuse him- or herself from discussion and decisions in matters where a conflict

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TOOLS: Conflict of Interest Policy

- Extreme circumstances (conflict is significant and unavoidable):
 - board member may be required to choose between resigning his or her position on the board and relinquishing his or her conflicting role and/or activities.



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SAMPLE Conflict of Interest Statement

Annual Board Member Conflict of Interest Statement

I, the undersigned, being duly elected to the board of directors of [name of nonprofit], hereby state that I have read and understand [name of nonprofit]'s *Conflict of Interest Policy* ("the Policy") and that to the best of my knowledge (except as noted below):

1. I, as an individual, don't transact any business, directly or indirectly, with [name of nonprofit];
2. I don't have a significant ownership interest, serve as an officer, director, employee, partner, proprietor or owner of 10 percent or more of the stock, in any corporation, partnership, or association that transacts business with [name of nonprofit];

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SAMPLE Conflict of Interest Statement

3. I don't have a business (including voluntary board and committee service) relationship with any corporation, partnership, or association that transacts business with [name of nonprofit];
4. I don't have any other professional relationship with any other organization, nonprofit or for profit, that might benefit from information learned during my board service with [name of nonprofit];
5. No member of my family is in the employ of [name of nonprofit], or would come within the meaning of preceding items 1-4; and

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SAMPLE Conflict of Interest Statement

6. Neither I nor any member of my family has any other relationships or interests that would reasonably be considered an actual, apparent or potential conflict of interest with [name of nonprofit].

My exceptions to the above statements are as follows:

I agree that if any situations arise, of which I am currently unaware, I will immediately notify the president of any conflict, actual, apparent or potential. I will fully disclose any such conflict and remove myself from any deliberation or vote concerning the issue. I agree to answer any questions the board may have with respect to any actual, apparent or potential conflict of interest.

Signature: _____ Date: _____

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How do conflicts arise?

- A conflict of interest may also arise when a board member serves on the board of two nonprofits
 - > both applying for the same grant?
 - > What's key in these cases?
 - Never use information they obtained around the board table at one organization to benefit the other organization unless the information is public knowledge.
- Conflicts also arise when a board member tries to steer business to a friend—a transaction that might not benefit the board member directly
 - > What could go wrong?

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Your Experience?



- Meeting the Duty of Loyalty



- The real world: recruiting and working with actual board members!

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The Duty of Obedience

- Requires that board members:
 - ensure that the nonprofit follows the laws that apply to it
 - including following its own mission, its articles of incorporation and its bylaws.
 - be faithful to the nonprofit's mission
 - ensuring that the corporation acts in a manner that is consistent with the mission and goals of the organization.

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The Duty of Obedience HOW?

- Monitoring activities to ensure that they are consistent with the nonprofit's underlying mission and goals
 - What do the bylaws and articles of incorporation say?
- What could go wrong?
 - Claims of malfeasance by a dissatisfied customer, funder, or constituent; charges may allege that board has failed to stay true to the organization's mission and purpose.

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The Duty of Obedience HOW?

- Required: that board act in accordance with the nonprofit's mission and all applicable laws and regulations including the nonprofit's own bylaws.
 - You're not required to be an expert in all the laws that apply to your nonprofit, but:
 - The board should at least be aware enough to **ask questions** and **hire professional help** to ensure compliance with statutory and regulatory requirements that apply.

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The Duty of Obedience - HOW?


- Board should receive periodic updates about:
 - changes in laws that apply to the nonprofit.
 - organization's compliance activities.
- Healthy boards are inquisitive, interested and engaged in the organization's success. This means the board should ask questions about legal compliance from time to time.

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Duty of Care

- Requires that board members be:
 - reasonably informed,
 - participate in decisions, and
 - act in good faith and with the care of an ordinarily prudent person in similar circumstances.



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Duty of Care



- Board members work to ensure that the organization has adequate financial resources to enable the nonprofit to fulfill its mission now and in the future.
- How can you do this with minimal information about the organization's services and programs?

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The Duty of Care: The Challenge

- Making certain that every member of a board is up to speed with respect to the nonprofit's programs and services.

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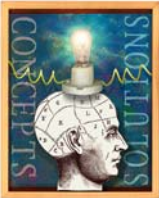
The Duty of Care: HOW?

- Management should:
 - Provide resources:
 - Orientation materials
 - Timely background documents
- The board should:
 - conduct an annual evaluation of the CEO (executive director),
 - provide thoughtful financial oversight,
 - monitor employment practices,
 - Carefully document the board's actions (official meeting minutes)
 - Ensure compliance with the Intermediate Sanctions, private inurement and private benefit provisions of the Internal Revenue Code.

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The Board Orientation



- How does it work in your organization?
- What approaches are available?

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Timely Materials

- Board can't meet its legal duty of care unless it has the time + opportunity to review information and formulate thoughtful questions
- Sufficient time to review written materials improves the odds that members will actively participate in board meetings.
- HOW?
 - Timetable for the preparation of board materials
 - Providing material at least one week prior to every board meeting.



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Evaluating the CEO

Goals:

- reaffirming the board's expectations of its chief executive,
- clarifying the board's goals and vision for the organization,
- helping the board to meet its legal duty of care by exercising oversight of the staff's activities,
- providing an opportunity to document the CEO's strengths and identify areas for improvement, and
- providing an objective basis for decisions about the CEO's compensation and benefits.



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Financial Oversight

- Ensuring that expenditures are consistent with the nonprofit's mission;
- Carefully reviewing financial statements to stay informed of financial affairs and posing questions to the nonprofit's senior finance personnel when concerns arise;
- Knowing whether the nonprofit has fulfilled its obligations under grant and other types of agreements;
- Ensuring that the nonprofit maintains and invests its financial assets in a sound manner;

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Financial Oversight



- Establishing policies that prevent the erosion of financial assets;
- Avoiding conflict of interests and recusing oneself from activities whenever an unavoidable conflict of interest exists);
- Engaging a qualified, independent accounting firm to conduct an annual audit of the nonprofit's financial statements.

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Monitoring Employment Practices

Key questions:

- Are the organization's personnel policies clear, consistent, and within the law?
- Does the nonprofit convey its policies to employees in a clear and concise manner?
- Is the organization fulfilling its end of the employment relationship?
- Has the organization identified other ways to reduce the likelihood of employment-related claims and challenges?



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Board Minutes


1. the date, time and place of the meeting
2. the name of the person chairing the meeting
3. the names of present members at the time of adjournment
4. the names of absent members
5. the existence or absence of a quorum
6. a concise summary of action taken by the board (e.g., all motions passed or not passed, such as approval of the annual budget)
7. the names of the person moving the motion, and the person who seconded each motion

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Board Minutes

8. a tally of all votes taken
9. the names of people dissenting (This is very important! If you don't dissent you are considered to have assented in an action—abstaining doesn't mean you dissented,) or abstaining from a vote or requesting that their vote be recorded
10. a list of all documents introduced during the meeting, with copies attached to the minutes
11. a summary of discussion points, but not a verbatim account of speeches
12. a summary of any commitments/next steps made by persons present
13. the signature of the secretary or other person vested with responsibility for taking the minutes.



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Don't Fear Absolutes

- Policies that must be followed
- Holding people accountable

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Directors' and Officers' Liability Insurance

- wrongful "management acts"
- duty to defend? reimbursement?
- who's insured?
- are employment claims covered?
- administrative complaints?
- defense of breach of contract claims?

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About Us

- Nonprofit Risk Management Center
- Free technical assistance to nonprofit leaders, staff and advisors
- www.nonprofitrisk.org
- Free tutorials and fact sheets on the Web site, plus affordable books, conferences, software and consulting help
- Melanie@nonprofitrisk.org

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PRODUCT SPOTLIGHT
The Seasons of Hope

The Essence of Youth Protection: Rules, Reporting and Consequences
By John C. Patterson

Organizations are obsessed with ferreting out sexual predators and preventing them access to young people. Unfortunately, in their zeal to do this, organizations focus too much on the sexual predator, and not enough on the safety of the children they want to protect.

Nearly every organization that offers services to children and youth has adopted some form of child abuse prevention. In 1993, when the federal National Child Protection Act was adopted, few organizations conducted criminal history record checks. Fifteen years later criminal history record checks have become a best practice. Organizations risk being pilloried in the public eye if a staff member is accused of committing child sexual abuse and the organization has

The Center's best-selling book, *The Season of Hope: A Risk Management Guide for Youth-Serving Organizations*, is a must-have resource that answers an array of questions about

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Other Resources

- My Risk Management Plan
➤ www.myriskmanagementplan.org
- Nonprofit CARES
➤ www.nonprofitcares.org
- Risk Management Classroom
➤ www.riskmanagementclassroom.org

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