Best Practices When Sitting on a Non-Profit Board

Claire H. Topp

August 31, 2017

Program Materials

PowerPoint Presentation

Corporate Governance: Under Fire in The 21st Century: "Topp" Ten Plus Best Practices for Governance in a Post-Enron Environment
Claire H. Topp, Dorsey & Whitney LLP (August 29, 2017)

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Best Practices When Sitting on a Nonprofit Board

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Outline of Presentation

- **Background**
- **Duties of Directors**
- **Personal Liability as a Director and Proactive Steps You Can Take**
- **“Topp 10” Plus Best Practices**
- **Questions**

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Background

- A changing environment within corporate governance.
- The Sarbanes-Oxley Act (American Competitiveness and Corporate Accountability Act of 2002) strengthened standards for governance in publicly-traded companies. Two provisions explicitly also apply to nonprofits:
  - Document destruction prohibitions
  - Whistleblower protections.
- Accountability Standards (Charities Review Council and Better Business Bureau Standards)

https://smartgivers.org/wp-content/uploads/2016/12/Accountability-Standards-2014.pdf

https://www.bbb.org/us/storage/0/Shared%20Documents/Standards%20for%20Charity%20Accountability.pdf

Accountability Wizard For Nonprofits

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Nonprofit Corporation Board of Directors' Duties

- Business affairs of a nonprofit corporation must be managed by or under the direction of the Board of Directors.

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Nonprofit Corporation
Board of Directors' Duties

- ✓ Clarify mission and assure it is carried out – Form 990
- ✓ Participate in development of strategic plan/oversee its implementation
- ✓ Annually review performance against strategic plan
- ✓ Approve annual budget and major transactions
- ✓ Oversee management but not directly manage
- ✓ Select, evaluate, remove the CEO
- ✓ Act in accordance with fiduciary duties (care, loyalty, obedience)
- ✓ Oversee (not rubber stamp) board committees
- ✓ Add individual perspective/experience/judgment
- ✓ Ensure financial solvency
- ✓ Oversee governance policies

Fiduciary Duties

- **Directors of a nonprofit corporation have three fiduciary duties:**
  - Duty of Care - be informed, actively participate in discussions and ask questions (you may rely on dependable sources).
  - Duty of Loyalty - act honestly and in good faith (disclose and abstain where conflict of interest).
  - Duty of Obedience - obey the law and the organization's governing documents and policies.

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Personal Liability
&
Proactive Steps

Personal Liability as a Director: Action by Attorney General

- **__Personal Liability:__ A Director may be liable for an action brought by the Attorney General for a breach of a fiduciary duty.**

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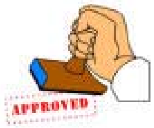

Personal Liability as a Director: Action by Attorney General

Proactive Steps for Duty of Care:

- Meet regularly – at least 3 meetings per year.
- Board should receive reports from committees and senior management sufficiently in advance of meetings for the Board to review and consider the contents of the reports.
- While the Board of Directors is permitted to rely on information, opinion and reports prepared by others, they cannot avoid their responsibilities. Board members need to actively question management and outside advisors when they see a "red flag."
- Must educate Board members that they are not only encouraged, but are required, to ask the hard questions so that they can be fully informed.
- Board must be careful to retain the necessary oversight over committees and not rubber stamp committee or senior management's recommendations.

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Personal Liability as a Director: Action by Attorney General

Proactive Steps for Duty of Loyalty:

- Should address both financial conflicts of interest and fiduciary conflicts of interest
- Directors with a conflict should disclose the conflict and abstain from approving the transaction
- Conflicted director present initially but then leave room for discussion and approval
- Important to address "appearance" of conflict of interest
- Document explored the same transaction with unrelated parties
- Board members should complete conflict of interest disclosure forms in a timely manner
- Consider whether to extend to certain staff

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Personal Liability as a Director: ERISA

Personal Liability:

- **Federal and state laws governing retirement plans, health insurance and other benefits are generally subject to ERISA.**
- **Under ERISA, directors and officers face personal liability with respect to these plans (because they are usually fiduciaries with respect to these plans).**
- **D&O insurance often excludes coverage of liabilities under ERISA.**

Personal Liability as a Director: ERISA

Proactive Steps:

- **It is possible to structure a benefit plan so that the directors are not considered a fiduciary under ERISA (fairly complex - need an employee benefit lawyer for that).**
- **Purchase an ERISA rider to the nonprofit's D&O insurance.**

Personal Liability as a Director: Approving Unreasonable Compensation

<u>Personal Liability:</u> (Section 4958 of the IRC)

- Applies if you are a director of a Section 501(c)(3) public charity or Section 501(c)(4) organization
- If you approve an Excess Benefit Transaction (including compensation for the nonprofit's CEO, CFO, COO, directors).
- A tax equal to 10% of the excess benefit (capped at $20,000 per transaction) may be imposed <u>on each director</u> who approves the transaction, knowing that it is an excess benefit transaction, unless the participation is not willful and is due to reasonable cause. All directors participating in the transaction are jointly and severally liable.
- Can't be indemnified and D&O insurance doesn't cover.

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Personal Liability as a Director: Approving Unreasonable Compensation

<u>Proactive Steps</u>:

Establish a Rebuttable Presumption of Reasonableness.

- Compensation is approved by the Board or a committee composed of individuals without a conflict of interest.
- Board relied on appropriate data as to the compensation's reasonableness.
- Board adequately documents the basis for its determination at the time it makes determination (not "after the fact").

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Personal Liability as a Director: Taxes

Personal Liability:

- **Employers are required to withhold federal income taxes and social security (FICA) taxes from their employee wages and are liable for payment of these taxes to the IRS.**
- **An individual that serves in a managerial or bookkeeping capacity (such as the Treasurer) of a nonprofit may be considered a "responsible party" for an entity that fails to pay withheld taxes to the IRS.**
- **A “responsible party” may be personally liable for a 100% penalty for such taxes (if there is a willful failure to collect and pay over the taxes).**

Personal Liability as a Director: Taxes

Proactive Steps:

- **Always withhold federal income taxes and social security (FICA) taxes.**
- **Know whether you are considered a “responsible party.”**

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Personal Liability as a Director: Dual Roles

Personal Liability:

- As a lawyer, you may be asked to act in the dual role as director and legal advisor.
- Questions may come up that are not within your area of expertise. Minnesota Rules of Professional Conduct states that you must always provide competent representation.
- Conflict of Interest situations may occur between your fiduciary duties as a director and your obligations under the rules of professional conduct as a lawyer.

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Personal Liability as a Director: Dual Roles

Proactive Steps:

- Make sure you know the area of law you are providing advice within.
- Disclose all conflicts and get consents as needed.
- If you are frequently called on to consult with the corporation regarding the actions of the Board you may be well-advised to choose one role or the other.

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Personal Liability as a Director: Protection - Statute

- Federal Volunteer Protection Act (the "VPA") and Minnesota state law together protect uncompensated directors from civil liability:
  - Must be uncompensated (reasonable expenses OK; nominal reimbursement)
  - Limits punitive damages and limitation of liability for noneconomic losses such as pain, suffering, and loss of consortium
  - Doesn't cover:
    - willful or criminal misconduct
    - gross negligence
    - reckless misconduct and flagrant indifference to the rights or safety of the individual harmed
    - Harm caused by a motor vehicle, vessel, aircraft (VPA doesn't cover/MN may)
    - an action or proceeding brought by the attorney general for a breach of a fiduciary duty as a director; or
    - a cause of action to the extent it is based on federal law, e.g., Section 4958 excise tax liability.

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Personal Liability as a Director: Protection - Statute

IMPORTANTLY

- Doesn't protect a nonprofit organization from liability
- Doesn't prohibit lawsuits against a volunteer, i.e. , the cost of defending such an action is still the responsibility of the director

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Personal Liability as a Director: Protection - Indemnification

- **Indemnification.** Nonprofit corporation required to provide to directors and officers if:
  - not already indemnified by another organization for the same liability;
  - acted in good faith;
  - received no improper personal benefit;
  - in the case of a criminal proceeding, did not have reasonable cause to believe the conduct was unlawful; and
  - the director or officer reasonably believed that the conduct was in the best interests of the participants or beneficiaries of the employee benefit plan.

Personal Liability as a Director: Protection - Insurance

- **D&O Insurance**
  - **Check homeowners policy**
  - **Depends on scope of nonprofit corporation's activities**
  - **Shop around**

CLE

NY CLE Verification Code

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Best Practices to Improve Your Effectiveness As a Director

BEST PRACTICES

1. Identify the various skills needed for effective board oversight; assess whether board composition is appropriate and adjust board (and/or committee) composition as needed

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BEST PRACTICES – Board Composition

- Directors bring a range of experience, diversity, knowledge and judgment (financial literacy is important) to the organization.
- The Board needs to proactively monitor on an ongoing basis whether the Board has the necessary tools to perform its oversight function effectively (not just take someone because of their willingness to serve).
- Board members should not be compensated for board services other than reasonable reimbursement for expenses directly related to their board service.
- Board members should not serve as the Chair/President and Treasurer simultaneously.
- No elected member of the Board shall serve for more than 5 years without standing for re-election.
- Should include independent members and should not be dominated by employees or others who are not, by their very nature, independent individuals because of family or business relationships.
- Consider term limits

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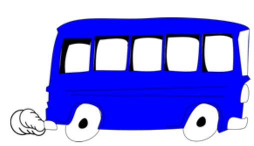
BEST PRACTICES

2. **Clearly define and communicate the respective roles of the Board, committees and senior management**

"TOPP" TEN BEST PRACTICES – Define Responsibilities

- **Establishing committees can improve the Board's effectiveness, particularly if the Board is large.**
- **Committees are subject at all times to the direction and control of the Board. The Board must clearly define the scope of responsibility of the committees (e.g., whether the committee has board delegated authority or has the authority only to make a recommendation to the Board).**
- **Although directors will have varying opinions about issues, Board members must operate "as a team" and "speak with one voice" once a full discussion has taken place and a decision has been made.**
- **Senior management is responsible for managing the everyday affairs of the organization under the oversight of the Board**
  - **Oversight is key**
  - **Strategy vs operational**
  - **Relationship with staff**



"TOPP" TEN BEST PRACTICES – Define Responsibilities

- **Dashboards are tools for presenting key performance metrics in a consolidated format and highlighting to the Board those that need attention.**
- **Most Boards want to discuss the vital few metrics that keep the Executive Director up at night.**
- **Board would work with Executive Director/CEO to develop the key performance metrics about which they should be informed.**
- **Include upcoming metrics (forward facing rather than backward looking)**

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Dashboard Examples

- **http://www.greatboards.org/pubs/bestpractices/Best_practices_dashboards.PDF (Middlesex Health System, Middletown, CT)**
- **http://dashboard.imamuseum.org/ (Indianapolis Institute of Arts); http://www.oneacrefund.org/results/dashboard/ (One Acre Fund)**

See also http://www.governancematters.org/data/org/56/media/doc/4695_gm_bl_board-edtensions.pdf

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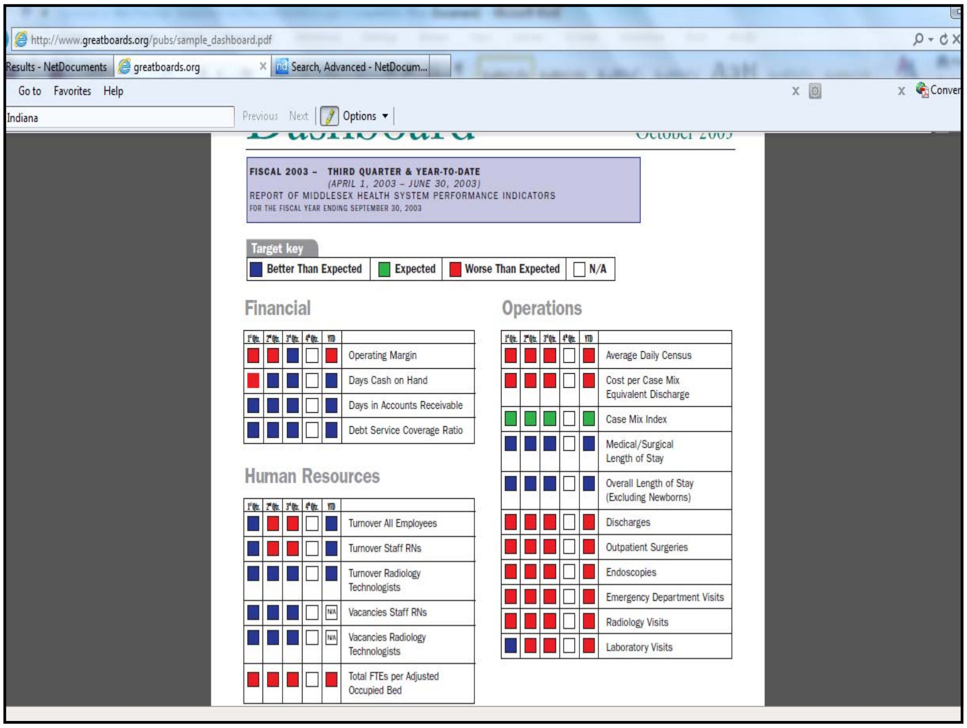
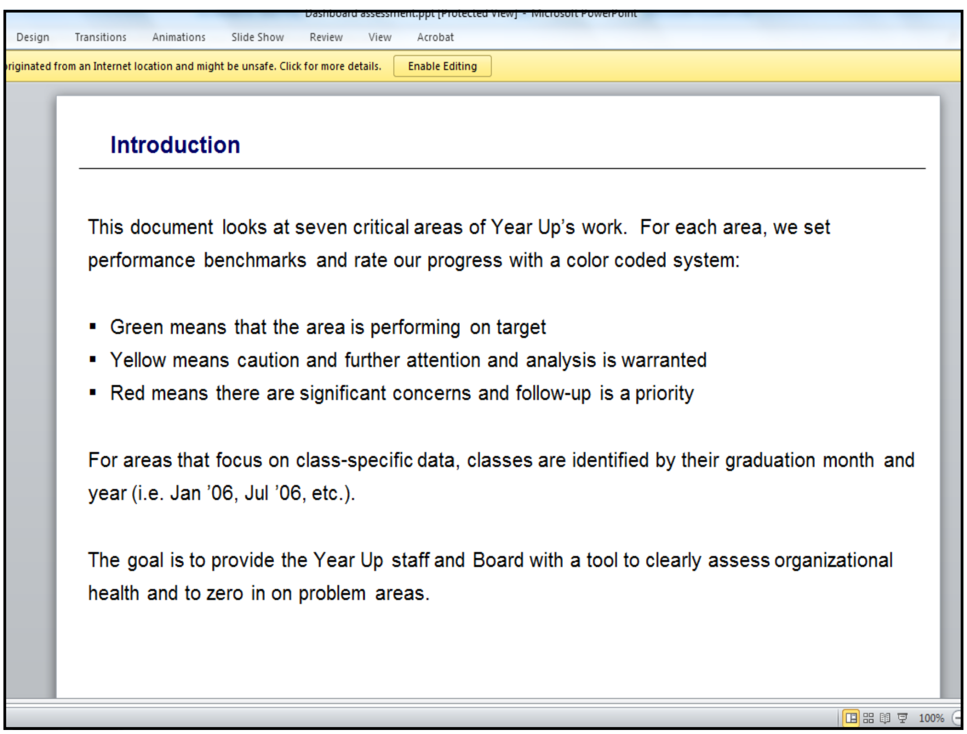




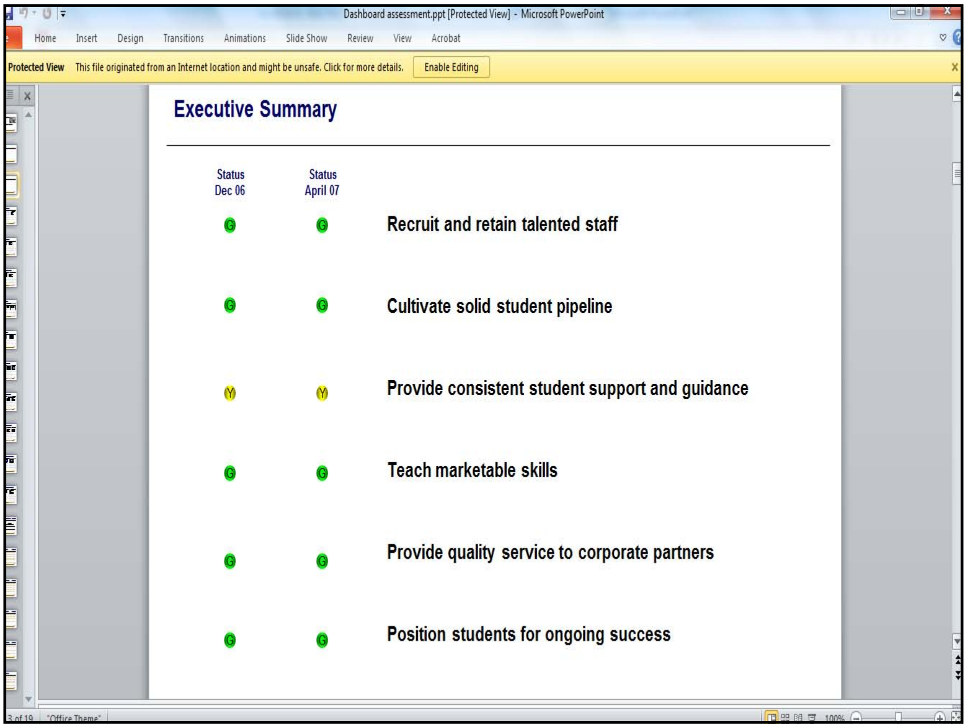
Introduction

This document looks at seven critical areas of Year Up's work. For each area, we set performance benchmarks and rate our progress with a color coded system:

- Green means that the area is performing on target
- Yellow means caution and further attention and analysis is warranted
- Red means there are significant concerns and follow-up is a priority

For areas that focus on class-specific data, classes are identified by their graduation month and year (i.e. Jan '06, Jul '06, etc.).

The goal is to provide the Year Up staff and Board with a tool to clearly assess organizational health and to zero in on problem areas.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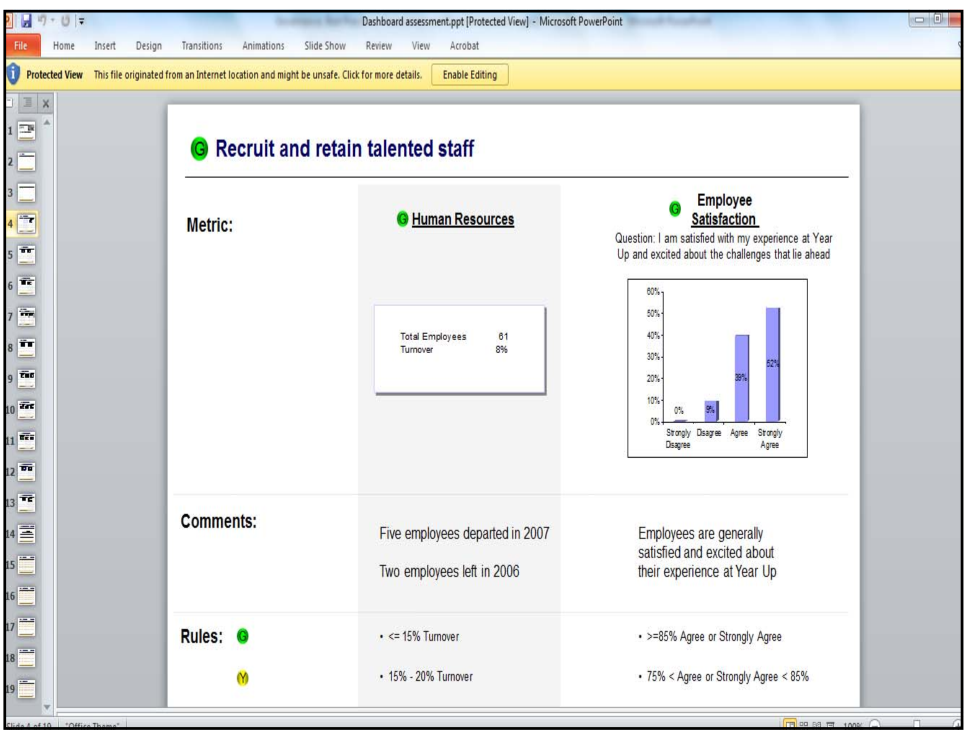
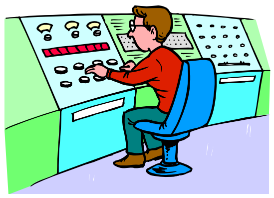
Protected View This file originated from an Internet location and might be unsafe. Click for more details.
Enable Editing
Executive Summary
Status Dec 06
Status April 07
Recruit and retain talented staff
Cultivate solid student pipeline
Provide consistent student support and guidance
Teach marketable skills
Provide quality service to corporate partners
Position students for ongoing success


Dashboard assessment.ppt [Protected View] - Microsoft PowerPoint
Protected View This file originated from an Internet location and might be unsafe. Click for more details.
Enable Editing
Recruit and retain talented staff
Metric:
Human Resources
Employee Satisfaction
Question: I am satisfied with my experience at Year Up and excited about the challenges that lie ahead
Total Employees 61
Turnover 8%
0%
9%
39%
52%
Strongly Disagree
Disagree
Agree
Strongly Agree
Comments:
Five employees departed in 2007
Two employees left in 2006
Employees are generally satisfied and excited about their experience at Year Up
Rules:
• <= 15% Turnover
• 15% - 20% Turnover
• >=85% Agree or Strongly Agree
• 75% < Agree or Strongly Agree < 85%

BEST PRACTICES

3. **Establish a system of internal controls that require senior management to inform the Board of significant transactions**



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BEST PRACTICES – Internal Controls

- **Adopt a policy outlining the types of transactions that need Board (or a Board committee) approval.**
- **Adopt a policy to ensure that no person bears the sole responsibility for receiving, depositing and spending the organization's funds.**
- **Board should consider requiring that the CEO or CFO certify (or at least review) the financial statements of the organization and the Form 990 or 990-PF.**

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BEST PRACTICES

4. Establish and implement an effective annual self-evaluation mechanism (including the opportunity for anonymous input) for the Board to review its performance and the performance of its committees

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BEST PRACTICES – Self Evaluation

- **A meaningful evaluation requires a review of the effectiveness of the Board, the committees and the individual Board members.**
- **Focus on whether Board members are able to effectively exercise the required oversight and seek improvement.**
- **Conduct an evaluation at least every 2 years.**

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BEST PRACTICES

5. Adopt a whistleblower policy and establish an appropriate anonymous means for employees and others to report compliance concerns

BEST PRACTICES – Feedback mechanism

- **Board should ensure that there is an appropriate and effective means for employees to report compliance concerns and make sure concerns are addressed.**
- **Strongly suggested by new Form 990.**
- **A hotline may not be appropriate for all organizations (expensive), but a suggestion box or other means for employees to report concerns may suffice.**
- **State laws that protect employees from retaliation for reporting concerns to government regulators do not require that employees first take their concerns to the employer.**

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BEST PRACTICES

6. Establish a Board audit committee comprised of independent Board members to oversee financial reporting, risk assessment and management practices

Audit Committee

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BEST PRACTICES – Establish an Audit Committee

- **The Audit Committee shall consist of Board members who are "independent."**
- **"Independent" means not being on the management team, not receiving compensation, not having a financial interest in, or any other conflict of interest with, any entity doing business with the organization.**
- **The Audit Committee shall engage auditors, review audit plans, and review financial statements, accounting policies and internal compliance programs, as well as tax, legal and regulatory matters.**
- **Members of Audit Committee should meet financial literacy standards (have accounting and financial management expertise).**

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BEST PRACTICES

7. Oversee finances, manage and spend organization's funds appropriately

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BEST PRACTICES – Oversee Finances

- **Use organization's funds in a responsible, effective and efficient manner to further the organization's mission.**
- **Board shall approve operating budget prior to beginning of each fiscal year.**
- **A nonprofit should ensure that it expends a significant percentage of its annual budget on programs that further its charitable purpose.**
- **The Board, either directly or through a board-authorized committee should ensure that the organization's funds are appropriately accounted for by regularly receiving and reviewing up-to-date financial statements and any auditor's letters or finance and audit committee reports, e.g., at least quarterly.**

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BEST PRACTICES

8. Be transparent to the public about your programs, governance and finances

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BEST PRACTICES – Be Transparent

- **Ensure that the organization's Form 990 (the IRS Information Return) accurately describes the organization's programs and finances.**
- **The organization's annual report shall include a description of the organization's purpose, activities, accomplishments and geographic area served, a summary of cost for each program, and a list of the Board members.**
- **Required to make available Form 1023 exemption application, Form 990, and Form 990-T, available for public inspection.**
- **The Internal Revenue Service encourages every charity to adopt and monitor procedures to ensure that its Form 1023, Form 990, Form 990-T, annual reports, and financial statements, are complete and accurate, are posted on its public website, and are made available to the public upon request.**

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BEST PRACTICES

9. Follow your own policies, procedures and audit recommendations

BEST PRACTICES –
Follow Policies

- **Make sure your organization follows its policies, procedures and audit recommendations.**
- **The Board should monitor management's compliance with such policies, procedures and recommendations.**
- **Consider having an independent consultant/attorney perform an internal assessment of the organization's compliance with its own policies, procedures and recommendations on an annual or biannual basis.**

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QUESTIONS

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August 29, 2017

Corporate Governance: Under Fire in The 21st Century "Topp" Ten Plus Best Practices for Governance in a Post-Enron Environment

Claire H. Topp[1]

1. Follow Policies. The nonprofit organization should follow its own policies, procedures, and audit recommendations and the Board of Directors should monitor management's compliance with such policies, procedures and recommendations. In particular, the nonprofit organization should have a written, mandatory document retention and periodic destruction policy which includes guidelines for electronic files and voicemail to guide employees in handling and disposing of documents, specifically focused on documents that may relate to "matters within the jurisdiction of an agency" of the federal government, whether it is tax matters within the jurisdiction of the Internal Revenue Service or employment matters within the jurisdiction of the Equal Employment Opportunity Commission. Such policy should provide that if an official investigation is underway or even suspected, the nonprofit organization should stop any document purging in order to avoid criminal obstruction charges. The nonprofit must also comply with all applicable federal laws and regulations, as well as applicable laws and regulations of the states and the local jurisdictions in which it is based or operates. The nonprofit organization should consider having an independent consultant/attorney perform an internal assessment of its compliance with its own policies procedures and recommendations on an annual or biannual basis.

2. Be Transparent. The nonprofit organization should be transparent to the public about its programs, governance, and finances in order to bolster public trust and confidence. In particular, the nonprofit organization should ensure that their Form 990 annual return filed with the Internal Revenue Service accurately describes its programs and finances. In addition, the nonprofit organization should have an annual report that includes a description of the organization's purpose, a description of its program activities, accomplishments and geographic area served, a summary of the total cost of each major program (to the extent required in the IRS Form 990) and a list of the organization's Board of Directors. Program names, activities and financial information listed in the annual report, audited financial statement and IRS Form 990 should be consistent. Where possible, the nonprofit organization should attempt to measure and share information regarding the outcomes of the nonprofit organization's activities.

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[1] Claire H. Topp is a Partner at Dorsey & Whitney LLP. Claire can be reached at 612-343-8278 or by email at topp.claire@dorsey.com.

3. Oversee the Finances. One of the core responsibilities of the Board of Directors of a nonprofit organization is to manage the financial resources of the organization and use them in a responsible, effective and efficient manner to further the organization's mission. To that end, the Board of Directors should approve an operating budget prior to the beginning of each fiscal year and receive financial reports, at least quarterly, comparing actual to budgeted revenue and expenses and should have policies and procedures to ensure that the organization is responsible in its management of funds Although having a reserve for the nonprofit organization's future is important, the Board of Directors should consider how its unrestricted net assets available for current use compares to the next year's budgeted operating expenses. For example, the Charities Review Council which sets accountability standards for nonprofits (www.smartgivers.org) recommends that the nonprofit organization's unrestricted net assets available for current use should not be more than twice the current or next year's budgeted operating expenses. Finally, the nonprofit organization should ensure that it expends a significant percentage of its annual budget on programs that further its charitable purpose while dedicating sufficient resources to ensure effective management of and fundraising for the nonprofit. While there is no absolute rule of thumb on the percentage of annual budget that should be spent on programs, many believe that a range of 65% to 70% of the annual budget spent on programs is reasonable.

4. Establish a Rebuttable Presumption of Reasonableness. Nonprofit organizations may protect themselves against assertions by the Internal Revenue Service that compensation is unreasonable by establishing a rebuttable presumption of reasonableness for all transactions with directors, officers, senior management and other "disqualified persons." To establish a rebuttable presumption that compensation is reasonable, the compensation must be approved by the Board of Directors or a board committee composed entirely of individuals who do not have a conflict of interest, the Board of Directors needs to rely upon appropriate data as to the reasonableness of the compensation prior to making its determination, and the Board of Directors must adequately document the basis for its determination at the time that it makes the determination (not "after the fact").

5. Establish an Audit Committee. The nonprofit organization should establish an separate audit committee of the Board of Directors consisting of directors who are "independent" to select and oversee the nonprofit organization's auditors, review audit plans and findings of the nonprofit organization's auditors, review financial statements, accounting policies, and financial reporting processes, review internal compliance program and tax, legal, and regulatory matters and engage independent auditors. A director is "independent" if the director (a) is not on the management team; (b) is not receiving any compensation (either directly or indirectly) from the nonprofit organization as a consultant for the professional services, though board service may be compensated; and (c) does not have a financial interest in or any other conflict of interest with any entity doing business with the nonprofit organization. Members of the audit committee should meet minimum financial literacy standards and at least one of the committee members should have accounting or financial management expertise. The full Board of Directors should approve the audit results.

6. Adopt and Abide by a Substantive Conflict of Interest Policy. The nonprofit organization should have a conflict of interest policy and should require that its Board members complete annual disclosures regarding their conflicts in a timely manner. Although most state laws require that the conflict of interest policy cover disclosure of financial conflicts of interest, many conflict of interest policies also cover disclosure of fiduciary conflicts of interest (e.g., a board member of a foundation serves on the board of a potential grantee). The non-conflicted members of the Board have the responsibility for determining whether a particular member has a conflict of interest. At the very least, directors should disclose the existence of a conflict, should abstain from voting on the transaction that is the subject to the conflict and the fact of any conflict and the action taken in response, including any abstention, should be recorded in the minutes. The Board should also consider whether the conflicted members should be permitted to participate in the meeting for some or all of the meeting considering the affect that participation would have on chilling the discussions among the non-conflicted members. In addition, if the Board of Directors decides to enter into a transaction with a party that has a conflict, the directors should document the reasons the transaction with the related party furthers the nonprofit organization's mission to a greater extent than entering into the same transaction with an unrelated party.

7. Ethical Fundraising. Fundraising is the life blood of a nonprofit organization and thus must be conducted with honesty, care and integrity. The Charities Review Council which sets accountability standards for nonprofits recommends the following (available at www.smartgivers.org):

- Solicitations and information materials clearly describe the purpose or programs for which the contributed funds will be used and identify the charity that will receive the contribution. The donor is provided with the address or phone number of the charity. All information provided in connection with solicitations is accurate and not misleading.

- Solicitations do not cause donors to feel threatened or intimidated. The nonprofit organization maintains a written policy to discontinue contacting any person upon that person's oral or written request directed to the charity, its professional fundraiser or other agent. Solicitors who are not employees or volunteers of the charity identify themselves in each solicitation as professional fundraisers and, upon request, provide the name and address of their employer or contracting party. Upon request, persons authorized by the charity to utilize the charity's name in connection with the sale or marketing of goods or services provide accurate information about the percentage of gross revenue that is paid to the charity.

The nonprofit organization should not compensate any fundraiser based on a commission or a percentage of the amount raised, including compensation to development directors and other employees.

8. Establish a Means for Employees to Anonymously Report Compliance Concerns. The Board of Directors and/or its audit committee should assure that there is an appropriate and effective means for employees to report compliance concerns and raise possible ethical issues about the nonprofit organization's practices (e.g., suggestion box or compliance hotline that is available 24 hours a day), and that the organization has a method for reviewing and addressing such concerns. The Board of Directors should have a whistleblower policy that sets forth a formal process to prohibit retaliatory action against any individual for raising concerns or questions regarding ethical matters, protects the confidentiality of individuals who make good faith reports or for reporting suspected violations. The nonprofit organization should adopt and regularly update a written code of ethics to ensure that it reflects the nonprofit organization's core value of integrity, including compliance with the laws, rules and regulations that govern the nonprofit organization's operations. The code of ethics should be discussed in board orientation and apply to and be signed by all employees of the nonprofit organization, as well as to directors, temporary workers, and other independent contractors and consultants when engaged by or otherwise representing the nonprofit organization.

9. Conduct Board and Committee Self-Evaluations. Meaningful evaluation requires an assessment of the effectiveness of the Board of Directors, the operations of Board committees and the contributions of individual directors. Accordingly, the nonprofit organization should establish and implement an effective annual self-evaluation mechanism for the Board of Directors to review its performance and the performance of its committees and an effective annual self-evaluation mechanism for committees of the Board of Directors (including the opportunity for anonymous input from Board members and committee members). The nonprofit organization should consider creating a new Board committee specifically charged with reviewing corporate governance issues on an ongoing basis.

10. Ask the Hard Questions. Directors have a fiduciary duty to be fully informed and to make necessary inquiry. Thus, the nonprofit organization should empower directors to ask the "hard questions" and should be sure directors have an opportunity to review and consider relevant information before making a decision. Conversations among directors regarding the "hard questions" should take place in a forum through which all directors can simultaneously participate in the conversation (i.e., not through e-mail). The nonprofit organization should offer new directors an orientation program and offer regularly scheduled briefings on various issues, including the nonprofit organization's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its code of ethics, its management structure and executive officers and its internal and independent auditors. Directors must maintain the confidentiality of information entrusted to them by the nonprofit and any other confidential information about the nonprofit that comes to them, from whatever source, in their capacity as a director, except when disclosure is authorized or legally mandated. While the Board of Directors is permitted to rely on information, opinions and reports prepared by others, including, but not limited to, senior management, the ability to appropriate rely on others is not an invitation to shirk individual responsibilities. Board members need to actively question management and outside advisors when they see a red flag. Further, Boards must be careful to retain necessary oversight over committees and not rubber stamp committee or senior management recommendations. The nonprofit organization should consider requiring executive sessions routinely every Board meeting so that the Board of Directors has an opportunity to meet without senior management present to strengthen the Board members' ability to review the nonprofit organization's performance and determine whether changes, improvements or other actions are needed to ensure that the nonprofit organization's strategies and practices are aligned with its mission.

11. Implement a System of Internal Controls. Boards should establish a system of internal controls and procedures for financial reporting and annually assess the effectiveness of the internal control structure. Internal controls should also require senior management to inform the Board of Directors of significant transactions so that the Board of Directors is aware of and can proactively monitor the nonprofit organization's activities. Nonprofit organizations should consider adopting a policy to ensure that funds are properly handled and that no one person bears the sole responsibility for receiving, depositing, and spending its funds, and that any certifications or reports made to funds, especially those administering federal funds, are correct and fairly represent the finances and operation of the nonprofit organization. Boards should consider requiring that the Chief Executive Officer and Chief Financial Officer certify the financial statements of the organization and the Form 990 or 990-PF. At the very least, the Chief Executive Officer and Chief Financial Officer should review the Form 990 or 990-PF before it is submitted to ensure that it is accurate, complete and filed on time. The Board of Directors should review and approve financial statements and Form 990 tax returns for completeness and accuracy.

12. Define Roles and Responsibilities. It is critical that the Board of Directors clearly delineate and communicate the respective roles and responsibilities of the Board of Directors, committees and senior management. In the changing and demanding environment of corporate governance, it has become clear that board committees can improve the board's effectiveness, particularly if the board is large. However, since committees are subject at all times to the control and direction of the Board of Directors, the Board of Directors must clearly delineate the scope of responsibility of each committee (e.g., whether the committee has board delegated authority or has the authority only to make a recommendation to the Board of Directors) and must be careful to retain necessary oversight over committees and not rubber stamp committee recommendations. Committee members should be thoughtful about the appropriate level of confidentiality under which they should conduct their discussions which will vary based on the nature of the discussions. Although directors will have varying opinions about different issues, Board members must operate "as a team" at the Board level, and must be able to "speak with one voice" once a full discussion has been undertaken and a decision has been made by the Board. The nonprofit organization should consider creating a nomination and governance committee responsible for shaping corporate governance policies and practices, monitoring nonprofit organization compliance with those policies and guidelines, reviewing and reporting on Board performance and overseeing Board membership, including director's qualifications and consideration of any changes in a director's responsibilities. The Board of Directors should also adopt a multi-year strategic plan and measure the nonprofit organization's progress against the plan at every Board meeting.

13. Assemble an Appropriate Board. Directors bring to the Board of Directors a range of experience, knowledge and judgment. The Board of Directors should monitor whether the Board of Director's members have the array of experience and skills necessary to perform its oversight functions effectively. Although nonprofit organizations need directors who are passionate about the organization's mission, nonprofit organizations also need directors who have a financial background. In addition, because the nonprofit organization's need for particular backgrounds and experience may change, the Board of Directors should monitor whether the Board of Director's members have the array of experience and skills necessary to perform its oversight functions effectively. The Board of Directors should proactively recruit board members to meet the Board of Directors' identified needs and consider the diversity of the Board. In addition, a substantial majority of the Board of Directors of a public charity (as opposed to private foundation) should be independent: (1) not be compensated by the nonprofit organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) receive, directly or indirectly, material financial benefits from the organization except as a member of the charitable class served by the organization; or (4) be related to anyone described above (as a spouse, sibling, parent or child), or reside with any person so described.[2] Additionally, both the Board Chair and Treasurer should be independent of senior management to provide appropriate oversight of senior manager's performance. The nonprofit organization's governing documents should explicitly address board terms and term limits.

Best Practice Resources:
Charities Review Council Accountability Standards – www.smartgivers.org

Principles for Good Governance and Ethical Practice, A Guide for Charities and Foundations. Panel on the Nonprofit Sector, October 2007 – http://www.nonprofitpanel.org/report/principles/Principles_Guide.pdf

[2] Excerpted from *Principles for Good Governance and Ethical Practice, A Guide for Charities and Foundations*. Panel on the Nonprofit Sector, October 2007