Welcome to the Board of Directors

An Orientation Manual for Directors

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Introduction

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

As a director, you and your fellow board members are responsible for overseeing the Organization's operations, while maintaining our commitment to its mission. This involves establishing our strategic direction, ensuring our compliance with all applicable legal requirements, and keeping our Organization financially healthy. This manual will help you understand your rights and responsibilities as a director so that you can effectively carry out these duties. We encourage you to refer to it whenever you have questions about your Board service.

Over the past several years, many groups and organizations have placed a great emphasis on nonprofit governance. Watchdog groups such as the Better Business Bureau's Wise Giving Alliance and Charity Navigator regularly rate charities based in large part on the organization's governance structure. The IRS Form 990, the reporting form that most charities must file with the IRS on an annual basis, asks for detailed information about every nonprofit organization's governance practices and policies. Donors, foundations and the press have also placed a greater emphasis on nonprofit governance.

We strive to maintain a Board that promotes a culture that meets the new generation of nonprofit standards. We see meeting these new standards as the best way to practice our mission and keep our Organization healthy.

Before you begin reviewing this manual, you should remember that you are not alone. When exercising your responsibilities, you may draw from the expertise of your fellow directors and management. In addition, you may rely on the expertise of individuals retained by our Organization to assist. These individuals include our legal counsel, independent auditors and insurance brokers.

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

Stay Exempt: This IRS website is designed to help nonprofit officers and directors maintain the organization's exempt status by reviewing the ongoing requirements for tax-exempt organizations. The website is https://www.stayexempt.irs.gov/.

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

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

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

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

As a director, you must meet certain legal responsibilities. This section is designed to give you some of the information you need to carry out those responsibilities. However, this material can only provide you with general information. It cannot address every situation that may arise and should not be construed as legal advice. Therefore, if the Board needs guidance regarding a specific situation, it should consult with legal counsel to determine what is appropriate on a case-by-case basis. In addition, if you have questions about any potential legal liability you may have as a director, you should consult Section 6 of this manual, *Risk Management and Directors' and Officers' Insurance*.

A. <u>The Tone at the Top:</u> The "tone at the top" refers to the ethical climate created in an organization by its leadership. You are an essential part of this. Through your leadership on the Board, you can foster a climate whereby the directors, employees, and volunteers act in a manner that upholds the highest ethical standards, while carrying out necessary duties. It is important to create this expectation for the Board and others. If you and your fellow directors appear unconcerned with maintaining high standards, this attitude may be observed and adopted by employees and volunteers as well.

The Board should make clear that, in making decisions, it is acting in what it believes is the best interests of our Organization to help carry out the mission. It is also the Board's responsibility to ensure that our Organization fully complies with all applicable federal, state and local laws.

You are expected to comply fully with our conflict of interest policy. You and the other members of the Board are also responsible for ensuring volunteers' and employees' compliance with this policy. In particular, the Board is responsible for implementing the whistleblower policy to ensure that any wrongdoing by a director, officer, employee, or volunteer is reported to the appropriate person, investigated fully and fairly, and does not result in retaliation against anyone bringing a claim in good faith.

B. <u>Duty of Care</u>: As a director, you must perform your responsibilities with the same care an ordinarily prudent businessperson would use in managing his or her own affairs. This means that you should act in good faith, stay informed and active, disclose to other directors material information that is not already known to them unless you are obligated to keep the information confidential, and exercise independent judgment when making decisions on behalf of the Organization.

The Board may delegate certain core Board functions to committees of the Board. Any committee authorized to act on behalf of the Board must be comprised entirely of Board members. The duties that may be delegated to committees of the Board are typically specified in the organization's bylaws.

The Board should delegate day-to-day duties to the Organization's senior management, subject to the Board's review and oversight. The Board may also appoint advisory committees, which are designed to advise the Board when carrying out its Board functions.

As a director, you may rely upon:

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

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

C. **Duty of Loyalty:** As a director, you must act in the best interests of the Organization and not for your personal benefit. To avoid impropriety or the appearance of impropriety, you must disclose to the Board any potential conflict of interest and refrain from participating in any decision of the Board in which you have such a conflict.

You cannot take advantage of business opportunities that would be of interest to our Organization without first offering them to the Organization. For example, if you see office space available for leasing at a favorable price, and you know that our Organization is looking to lease office space, you should not lease the space without first disclosing the fact that the space is available and allowing the Organization an opportunity to try and rent the space.

In addition, under District of Columbia laws, you cannot borrow money from the Organization, nor can you authorize the Organization to loan money to any officer or other director of the organization, except under limited circumstances such as to provide an advance to pay reimbursable expenses that the director may incur.

The Board has adopted a conflict of interest policy that applies to all directors and senior managers. Every year, you should fill out the conflict of interest questionnaire. Familiarize yourself with the conflict of interest policy and ensure that you and your fellow directors follow it.

D. **Duty of Obedience:** All directors must act in a manner consistent with the provisions of the articles of incorporation, bylaws, and tax-exempt status of the Organization. You should be familiar with our mission and take it into account with every decision you make for the Organization. In addition, you should help the Organization comply with all federal, state and local laws as they apply to the Organization.

E. <u>Duty to Inform</u>: Officers have a duty to provide the Board of Directors with any information the officer has learned while performing his or her duties that is material to the Board in carrying out its responsibilities to the Organization.

An officer also has an obligation to inform a superior officer, the Board of Directors, or other appropriate person if the officer believes that another person has engaged or is likely to engage in a material breach of duty to the Organization or in a material violation of the law involving the Organization. If you serve as an officer of the Organization as well as a director, you must comply with the duty to inform. If you only serve as a director, you too must inform your fellow directors of any wrongdoing as part of carrying out your duty of care to the Organization.

F. <u>Confidentiality</u>: You should not disclose information about the Organization's activities unless the Board decides to make the information public, or unless the information is a matter of public record.

G. <u>Attendance</u>: You should demonstrate your commitment to the Organization by regularly attending Board meetings and meetings of the committees to which you have been assigned. This will allow you to stay informed of activities, while the Organization, in turn, will benefit from the skills you bring to the Board.

You may attend meetings without being physically present. For example, you may participate via conference call, provided you can hear all the other participants in the meeting and they can hear you. However, being a member of the Board of Directors is a personal responsibility that cannot be delegated to others. Therefore, under the law you cannot give someone else the authority to attend a Board meeting or vote on your behalf. Specifically, you cannot vote by proxy.

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

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

Therefore, when you request information from management, it is important that you are reasonable in the frequency and scope of your requests. Your requests should be suited to what you need to perform your job as a director, and not to the day-to-day management of the Organization.

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

You will receive advance notice of each meeting so that you can prepare for the meeting and plan to attend. The amount of advance notice for each type of meeting is specified in the bylaws. If you do not receive the proper amount of advance notice, you can still attend the meeting and participate.

On some occasions, the fact that you did not receive proper advance notice may be detrimental to the Organization. In such a case, you have the right to object to the fact that you did not receive proper notice. However, if you do so, your participation at the meeting must be limited to making your objection. If you participate in the substance of the meeting, you will be considered to have waived your right to make an objection.

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

I. **Private Inurement and Private Benefit**: The Internal Revenue Code gives tax-free status to charitable organizations because they provide important benefits to the public. However, the Internal Revenue Code also provides that a tax-exempt organization must be operated for the benefit of the public and not for the benefit of "insiders." This is called the private inurement rule. As a director, you must ensure that insiders do not receive favorable treatment. Otherwise, our Organization risks losing its tax-exempt status. Some examples of favorable treatment may include paying more than fair market value for goods or services provided by an insider, or creating a job for someone just because he or she is related to an insider.

"Insiders" is defined by the Internal Revenue Service (IRS) as anyone with a unique position in the Organization that allows him or her to control or influence the Organization and the application of its funds or assets. Insiders include the following:

- Founders;
- Officers;
- Members of the Board of Directors;
- Senior staff members, and
- Any of the above individuals' relatives such as a spouse, parent, siblings and their spouses, children and their spouses, and great grandparents, grandparents, grandchildren, and great grandchildren and their spouses.

It is permissible to give a benefit to any individual, even a director that qualifies under the Organization's normal charitable guidelines.

In addition, as a director you must make sure that the Organization's activities further the public good and are not for someone's private benefit. Therefore, you should make sure all of our Organization's business transactions are in its best interests and help it carry out the mission.

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

One exception to the example above may be if the tenant is another tax-exempt organization. In such case, it may be acceptable to charge a lower rent or no rent at all to provide assistance to the other charitable organization because it also helps our Organization carry out its tax-exempt mission.

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

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

- The Board approves the transaction in accordance with the Conflict of Interest Policy before you provide the goods or services;
- You receive only fair market value for your goods or services; and
- The Organization properly documents and reports the transaction.

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

K. Political Activity and Lobbying

1. Lobbying

As a tax-exempt entity, our Organization may engage in limited lobbying activities. For this purpose, the Organization will be regarded as lobbying if it attempts to influence legislation. Attempts to influence legislation include contacting or urging the public to contact members or employees of a legislative body for the purpose of supporting or opposing legislation, or advocating for the adoption or rejection of legislation.
Legislation includes actions by Congress, the city council, state legislatures, or any other elected body, such as a school committee, with respect to acts, bills, or resolutions. It applies to such actions as confirming an individual for office, such as a judge or cabinet member. It also applies to ballot initiatives or similar procedures to be voted upon by the public. The definition of legislation does not include actions taken by the courts or government agencies.

As noted above, there are limits on the amount of lobbying in which our Organization may engage. The Internal Revenue Code provides that a nonprofit that is exempt under Section 501(c)(3) cannot direct a "substantial" part of its activities towards lobbying. If the Organization engages in excessive lobbying, it will be subject to an excise tax and will be at risk of losing its tax-exempt status.
As a director, you should ensure that our Organization complies with the rules against excessive lobbying. In addition, certain lobbying activities may require the Organization to register as a lobbyist with various federal, state and local government authorities. If the Organization wishes to engage in any lobbying activity, the Board should work with legal counsel and senior management to ensure that procedures are put in place to comply with these regulations and the IRS limitations on lobbying activities.

2. Rules Prohibiting Political Activities

Under the Internal Revenue Code, our Organization, like all tax-exempt charities, is strictly prohibited from intervening on behalf of, or in opposition to, candidates for local, state, or national office. If the Organization violates this rule, it is subject to an excise tax on the amount expended on the campaign activity and faces the risk of losing its tax-exempt status.

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

If you are in any doubt as to whether your activities would be considered improper political activities on behalf of our Organization, you should consult with the Board officers and legal counsel before engaging in those activities.

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

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

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

2. Fundraising

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

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

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

Even though the Board is ultimately responsible for the Organization's fundraising strategy, the fundraising activities will not succeed without a close partnership with management. There must be a close collaboration between the Board and management, as well as clearly defined goals for management to execute. Therefore, it is key for the Board to specify the responsibilities of both management and the Board in the fundraising effort.

B. **<u>Fundraising Practices</u>:** The Board should ensure that our Organization follows ethical fundraising practices and that its fundraising efforts are cost-effective. It is the Board's responsibility to ensure that the Organization's fundraising programs reflect well on our Organization and mission. Therefore, the Board must exercise the following responsibilities:

1. **<u>Restricted Donations</u>:** Frequently, a donor will contribute to the Organization and place restrictions on how such funds may be used. For example, the donor may want to fund a specific initiative or activity. In addition, the Organization may solicit funds with the promise that the donations will be used for a particular purpose. These are called restricted funds. As a member of the Board, you are responsible for ensuring that these funds are used for the purpose the donor specified, and not for other expenses such as overhead or other program activities. You should ask that any financial reports you receive specify whether the income is restricted or unrestricted, so that you can ensure that the donor's wishes are being carried out.

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

3. **<u>Fundraising Techniques</u>:** Our Organization's most valuable asset is its good name. One way the Organization may forfeit its good name is by engaging in inappropriate fundraising practices. In the past few years, stories have appeared in the media highlighting questionable fundraising

methods employed by otherwise legitimate charities. Therefore, it is important that the Board ensure that people soliciting funds on the Organization's behalf receive appropriate training and supervision. Those conducting solicitations should not employ techniques that are coercive, intimidating, or intended to harass potential donors.

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

5. **Charitable Solicitation Laws:** Most states and the District of Columbia regulate the solicitation of contributions by charitable organizations. To solicit funds in the District and various states, our Organization must register with the local government. Therefore, unless it qualifies for an exemption, the Organization is required to register with the District government and with each state, such as Maryland and Virginia, where it solicits funds from individuals, foundations, or businesses located in that state. The Board is responsible for ensuring that the Organization complies with the various charitable solicitation laws.

6. **Privacy Policy:** Our Organization respects the privacy of individual donors and, except where disclosure is required by law, will not sell or otherwise make available the names and contact information of donors without providing them an opportunity at least once a year to opt out of the use of their names.

C. **Board Participation:** In addition to the preceding tasks, each member of the Board should show his or her personal financial support for the Organization. Directors may also contribute to our Organization other ways, such as through their understanding of the community in need or their prior nonprofit experience. Directors also offer specialized skills such as human resources or financial expertise. The Organization cannot succeed without those contributions.

However, we cannot expect others to financially support the Organization if the Board does not. Your personal participation is essential to a successful fundraising campaign. Our Organization does not expect its directors to donate a minimum dollar amount to the Organization. However, we do ask you to contribute to the Organization's annual fundraising campaign. The Organization's goal is to have 100 percent participation by the Board.

In addition, you should help management identify and evaluate prospective donors, including individuals, corporations, and foundations. As a director, you should also assist in cultivating prospective donors by stimulating interest in the Organization and its work.

3. Board's Responsibility for Financial Oversight

Because our Organization is fortunate that so many people support us by giving their time and money—often at great sacrifice to themselves—it is important that we exercise good stewardship in managing the donations of our supporters.

The senior management plays a key role in managing the financial affairs of the Organization, but the Board has ultimate responsibility for ensuring that its funds are properly utilized. Indeed, because the oversight responsibility involves a review of the financial decisions made by officers, the Board must pursue certain conversations and actions independently of senior management's influence.

In recent years, the IRS has increased its financial oversight of nonprofit organizations. Several states also have started extending financial governance principles, previously applicable only to public companies, to nonprofit organizations. Grant makers and other donors also expect nonprofit organizations to exercise robust financial oversight. Therefore, the Board should have clear policies and procedures to protect our Organization's financial assets and ensure that the Organization is following best practices.

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

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

A. **<u>Policies and Procedures:</u>** While it is management's responsibility to oversee the day-to-day accounting and financial management of the Organization, the Board is responsible for ensuring that proper financial systems and controls are in place. For example, the Board should make sure there is a policy in place to require that at least two unrelated individuals are responsible for receiving, depositing, and spending the Organization's funds. The Board is also responsible for reviewing practices and reports to ensure that staff members are complying with Board-approved policies.

B. <u>Budget and Expenses:</u> The Board is responsible for reviewing and approving our annual budget. The Board should also receive financial reports on a regular basis several times a year. The reports should show budgeted and actual expenditures as well as budgeted and actual revenues. By carefully reviewing the regular financial reports, the Board will be able to determine whether it must adjust spending to accommodate changes in revenues.

However, prudent financial oversight requires that the Board look beyond periodic financial reports to consider how the Organization's current financial performance compares with that of previous years, and how its financial future appears. If our Organization's net assets decline over a period of years, or if future funding seems likely to decrease significantly, the Board may need to take proper steps to achieve or maintain the financial stability of the Organization.

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

- Will our Organization maintain an endowment where the donor may place permanent restrictions on funds that may be used to serve our purpose?
- How much of an operating reserve should we have (i.e., three months of operating expenses)? Under what circumstances can the Organization use the operating reserve? Who makes the decision to use the operating reserve?
- Are there any restrictions in how we will invest our funds? For example, does the Organization wish to invest in the stock of companies that manufacture armaments or alcohol, maintain gaming establishments, etc.?

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

- The needs of the Organization and the general economic conditions, including the possible effects of inflation and deflation;
- The expected total return for an investment, including appreciation, and how that plays within the overall investment portfolio;

- The need to preserve capital versus the need to generate income;
- The other resources available;
- An asset's special value, if any, to the Organization; and
- Any expected tax consequences with respect to an investment.

In managing the funds, the Board may incur appropriate costs that are reasonable in relation to the amount of assets being invested and the purposes of the Organization.

By following these steps, we will succeed as good stewards of the Organization's funds in a manner that helps carry out the mission.

4. Strategic Planning

With senior management, the Board takes the lead in mapping out the strategic direction of our Organization. The Board takes time every three to five years to develop a long-term plan for the Organization, to ensure its future sustainability and growth.

The starting point of any strategic plan is the mission statement. Both the Board and senior management must have a good understanding of the mission and how current activities serve that mission.

Next, the Board must have a good grasp of the interests and concerns of our various stakeholders. What resources exist to meet the needs of the community we intend to serve, and what needs have not been met? The Board determines whether the activities the Organization engages in, or may want to engage in for the future, are:

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

Third, the Board determines whether existing programs are effective in carrying out the mission. Is the Organization meeting the goals it set out to achieve? Are there more effective ways to achieve the mission? Does the nonprofit have to shift the focus of its mission to meet current or future stakeholder needs?

Finally, the Board evaluates the resources available to enable the organization to undertake activities the Board has identified to help meet the needs of its stakeholders or expand its services.

Once the Board has evaluated current activities against the mission statement, taken stock of the needs of its stakeholders, and determined what resources are available to assist our Organization in carrying out its mission, the Board and senior management are ready to develop a strategic plan. The plan will guide activities and initiatives from year to year. It will help the Board and management evaluate new opportunities as they arise, to see if they are consistent with the direction in which the Board and management want to take the Organization.

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

5. Overseeing the Performance and Compensation of Management

The chief executive of the Organization is hired and supervised by the Board. The Board also has the authority to fire the chief executive if he or she is not meeting the performance standards set by the Board.

The Board reviews the performance of the chief executive annually. By giving feedback at least once a year, the Board assists the chief executive in performing to the best of his or her abilities.

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

The good news is that the Board can significantly reduce the risk of paying compensation to senior management that will be considered excessive. The Internal Revenue Code provides a three-step process that, if followed, will result in the IRS presuming that the compensation is reasonable. The three steps are:

1. The Board (or a committee of the Board authorized to set compensation) must approve the compensation level;
2. The Board (or committee) must make use of data showing how much similar organizations are paying their employees to determine that the compensation is reasonable; and
3. The decision-making process and compensation must be properly documented and reported.

A. **<u>Prior Approval by Authorized Body:</u>** To satisfy the first requirement, either the Board (or Board committee) must approve the compensation package **in advance**.

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

The following are the principal reasons why a director would have a conflict of interest:

- You are participating in or economically benefiting from the compensation arrangement being voted on, or you have a family member benefiting from the compensation arrangement.

- You are an employee subject to the direction or control of a member of management whose compensation is being voted on.

- You receive compensation or other payments that must be approved by a member of management whose compensation is being voted on.

- You have a material financial interest that would be affected by the compensation package being voted on.

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

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

    ➢ *Example: The chief executive sits on the Board of a nonprofit that employs your spouse. As a member of that board, the chief executive would be expected to vote on your spouse's compensation package. Therefore, as a member of our Board, you may not vote on the chief executive's compensation package because your vote may be influenced by your desire to increase your spouse's compensation, which will provide an economic benefit to you as well.*

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

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

Information that may be used to make the comparability determination includes:

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

Comparability data way be obtained a number of ways. The Organization may hire a compensation consultant to review the Organization's compensation structure. Alternatively, the Board can also purchase compensation comparability data from organizations that provide technical assistance to other nonprofits or from human resource companies that compile that information for a fee. Finally, the Organization can use publicly available information on Web sites such as www.guidestar.org to determine what comparable organizations are paying their employees.

As a starting point, the Board must have a clear understanding of which organizations qualify as "peers" for purposes of making comparisons. The peer organizations may be different for different positions. For example, if the Organization were hiring a director of information technology, it may want to look at comparably sized for-profit businesses as well as nonprofit organizations to determine the appropriate level of compensation.

C. **Proper Documentation of the Decision-Making Process and Reporting of the Compensation:** The third component of the IRS procedure for setting management compensation requires ensuring that the decision-making process is properly documented. The documentation may be written or electronic, such as written minutes or an e-mail summary of the meeting. The documentation must include:

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

The documentation must be completed in a timely manner. This means that the Organization must prepare the records before the later of:

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

In addition, the Board or committee must review the documentation and make any needed corrections to the documentation within a reasonable amount of time. Finally, the Organization must report the compensation on the IRS Form W-2 issued to the recipient of the compensation (if he or she is an employee) or IRS Form 1099 (if he or she is an independent contractor), as well as the IRS Form 990.

Our Organization must comply with all three steps to establish the rebuttable presumption of reasonableness; we will forfeit the protections the safe harbor affords if our Organization fails to meet any one of the three. Additionally, establishing the rebuttable presumption of reasonableness is considered to be a "best practice" in terms of nonprofit governance, and the IRS will ask our Organization to disclose the method used to set management's compensation when we complete the annual IRS Form 990.

6. Risk Management

A. <u>Liability of the Organization</u>: Our Board protects the assets of the Organization, ensuring those assets are available to serve the mission. To do so, the Board implements a risk management plan.

The three basic steps in any risk management plan are:

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

The Board works with management to identify activities that create risks for our Organization. Next, the Board evaluates procedures that may lessen the risk that a bad event will occur, such as better employee training or the purchase of safety equipment. The final step is to work with our insurance broker to see whether the Organization can insure against the risk that such a bad event occurs.

B. <u>Liability as a Director</u>: As a director, you may be subject to a lawsuit if someone alleges that you failed to carry out your duties appropriately, or that you acted in a discriminatory fashion in connection with someone's employment or the provision of nonprofit services. To protect yourself from liability, consider these three steps:

1. **<u>Prevention</u>:** Exercise your duties as a director with due care and ensure our Organization acts in accordance with legal requirements. This is the best way to avoid liability. If you carry out your duties as a director diligently and with due care, you will be much less likely to encounter legal problems.

2. **<u>Indemnification</u>:** One way to protect yourself against liability is to seek an indemnification if a claim is made against you as a director. An indemnification means that the Organization will pay the attorney's fees you

incur and any legal damages you have to pay in connection with any acts you commit while serving on the Board. An indemnification may be authorized once the Board has met to review the matter and vote on whether you acted in accordance with the relevant standard of conduct. In general, you will be eligible for indemnification as long as you acted in good faith and in the best interests of the organization. In the event that you successfully defend or dismiss a claim brought against you as a director, the Organization will be required to indemnify you. Indemnification provisions are found in the governing documents. You should consult the Organization's attorney to determine the extent to which the articles of incorporation and bylaws permits indemnification.

3. **Directors' and Officers' Insurance:** Another alternative is for the Organization to purchase Directors' and Officers' Liability Insurance (D&O insurance). Under most D&O insurance, you will be insured for your legal defense costs if you are sued, and the insurance will pay any settlement for claims covered by the policy, subject to any exclusions in the policy.

7. Board Evaluation

The final task the Board must undertake is to periodically evaluate its own performance. It is important for the Board to meet annually to discuss how it can improve its performance. The Board should determine which skills the Board may be lacking, and whether it can recruit a new member with those skills. For example, most Boards continuously need members with backgrounds in finance, human resources, and the law.

Moreover, each director must be engaged in the work of the Board. If the directors are not fully engaged in the Board's work, the Board should discuss steps it should take to re-engage its members. Without a fully engaged Board, most work will likely fall on a few individuals, resulting in many tasks not being done, while also putting members of the Board who are most engaged at risk of becoming burned out.

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

Conclusion

Again, we want to express our appreciation of your willingness to serve as a director of our Organization. Many exciting challenges lie ahead, and we are grateful that you have accepted the responsibility of being a member of the Board.

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

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