

# Serve on a Not-for-Profit Board?

## A Primer on Board Responsibilities

Are you new to a not-for-profit (NFP) board? Board service is a wonderful way to get involved in an important cause, but did you know that it is a role that comes with a great deal of responsibility? As part of the organization's governing body, you will be called on to contribute your expertise, help establish strategic objectives, and provide guidance to help your organization achieve its mission. Along with this responsibility comes legal and ethical obligations to the entity. An NFP's board has liability for the organization, and therefore, it is the final authority.

This article is intended as a primer on basic board responsibilities for those who are new to NFPs, or who just need a refresher. If you have specific questions about board service and responsibilities, you should consider consulting legal counsel familiar with applicable state and federal laws. Not-for-profit boards frequently call on attorneys who specialize in nonprofit law to provide a more complete picture of legal requirements. This article is not a substitute for legal advice.

### Board Objectives

Whether its members are elected or appointed, the typical NFP board has the following basic objectives:

- Set strategic objectives to be accomplished
- Create policies to guide the implementation of activities designed to assist the entity in meeting its strategic objectives
- Serve as content matter experts and a sounding board for the chief executive
- Hire the chief executive and monitor his or her progress toward meeting strategic objectives
- Establish a governance process and assess its performance in meeting its objectives
- Assume responsibility for the entity's compliance with laws and regulations and provisions of funding source agreements

### Responsibilities of the Board

The responsibility of the board can be broken down into three general categories – strategic, legal, and fiduciary.

## *Strategic Responsibilities*

### Mission

The board is charged with helping the NFP achieve its mission. A clearly articulated mission statement, adopted by the board of directors, serves to explain and popularize the organization's purpose and guide its work. It also addresses why the entity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom. As such, one of its most important responsibilities is to set and oversee the implementation of strategic objectives for the organization to fulfill the mission. Strategic objectives are specific, measurable goals that the NFP plans to achieve while carrying out its mission. Examples of strategic objectives include:

- Reducing homelessness in a particular area by 10% within the next 2 years
- Providing school supplies to 100% of elementary school students in a specific school district for 5 consecutive years
- Reducing texting-related traffic accidents by 40% over the next 5 years
- Providing start-up grants to 100 home-based businesses in the next 12 months

### Strategic Plan

The strategic plan is a disciplined effort to produce fundamental decisions and actions that shape and guide what an organization does, and why it does it. An NFP will evaluate the success of its programs and determine whether the organization is achieving desired results and outcomes. Performance measurement informs the strategic planning process. Strategic planning is typically conducted on a regular basis, separate from the other business conducted at regular board meetings.

### Hiring the CEO

Perhaps the most important function of the board is to hire and evaluate the chief executive who is then responsible for leadership decisions that permeate the rest of the organization. When hiring a chief executive, the board should start by making a comprehensive list of the qualities it requires. Once a chief executive is hired, it is the responsibility of the board to support, supervise, and evaluate them. This may include termination if the stated objectives are not met. It is critical that board members maintain a level of independence and skepticism when evaluating management's plans and performance.

### Compensation of Executives

The board is also responsible for setting the appropriate compensation of the chief executives. When a charitable organization is compensating an executive (Executive Director, CFO), the board needs to be aware of the rebuttable presumption of reasonableness provisions contained within §4958 of the Internal Revenue Code. Essentially, the charitable organization needs to ensure that the full board, without any involvement by the individual whose compensation is being determined, votes on whether to approve (or

not) the executive compensation arrangement before it is implemented. In order to make the decision on whether to approve the executive compensation arrangement, the board reviews and analyzes salary surveys, comparability studies, etc. And finally, this entire process needs to be contemporaneously documented (i.e. at the same time). Effective January 1, 2018, as a result of the Tax Cuts and Jobs Act of 2017, executive compensation in excess of \$1 million is subject to a 21% excise tax.

## Board Evaluation

In addition to evaluating the chief executive's performance, the board should evaluate its own performance as a governing body and as individuals contributing to accomplishment of the organization's mission. The evaluation should be done, at a minimum, every three years. Clear policies and procedures setting the length of board member terms and the number of consecutive terms a board member may serve are imperative.

## *Legal Responsibilities*

There are three broad legal responsibilities of the board: the duty of care, the duty of loyalty, and the duty of obedience. Failure to ably carry out this role puts the entire organization in jeopardy.

### Duty of Care

The duty of care requires the board to conduct the affairs of the NFP in a way that a prudent person would. Board members are expected to make reasonable and sound judgments when acting on behalf of the NFP. Active preparation for, and participation in, board meetings where important decisions are to be made is an integral element of the duty of care.

### Duty of Loyalty

The duty of loyalty requires the board to be loyal in its dealings with the NFP and to put the organization's needs above its own. A board member should never use information obtained as a member for personal gain. A robust conflict of interest policy covering both financial and nonfinancial conflicts is fundamental to fulfilling the duty of loyalty.

### Duty of Obedience

The duty of obedience requires the board to be faithful to the mission of the organization. Board members should not take action that is inconsistent with the NFP's mission. The board's responsibility to ensure compliance with laws and regulations falls within this responsibility.

## *Fiduciary Responsibilities*

A fiduciary duty is defined as the obligation to act in the best interest of another party. For board members, that means acting to protect the property, financial assets and, most importantly, the reputation of the organization. The board is responsible for evaluating financial policies such as investment and debt policies, approving annual operating and capital budgets, and reviewing and analyzing financial information to ensure that the organization has the resources necessary to fulfill its mission while remaining accountable to its donors and other stakeholders. The board is also responsible for ensuring that the NFP has adequate insurance coverage and that controls are in place to ensure the security of private information.

Some smaller volunteer-led nonprofits may have no staff, so board members could be expected to occupy more hands-on operational roles. Although this is not ideal because it is difficult for the board to monitor and challenge its own activities, it is a reality for many smaller NFPs. Where paid staff is available, the board should function as policy setter and advisor and monitor the results of established goals and plans.

Board members are usually very busy and accomplished individuals. While it is not necessary for every board member to be a financial expert, each member should be able to do the following:

- read and understand the organization's basic financial statements;
- ask informed questions about the organization's use of resources and its financial soundness, including its liquidity position;
- understand the entity's investment strategy and ensure that it is consistent with strategic goals;
- read, understand, and approve the annual budget;
- ensure that all necessary filing requirements and tax obligations have been met; and
- review the IRS Form 990 Return of Organization Exempt from Income Tax, ideally before it is filed.

An NFP should provide board members with the tools necessary to ensure that they are able to fulfill their fiduciary responsibilities, starting with a new member orientation. The most common way of accomplishing this is by providing a dashboard which summarizes the information that board members are most interested in. The amount and type of information will vary by size, type, and complexity of the organization, but the board, not management should decide what information they would like and how often. That information might include:

- metrics related to programs so that performance can be assessed against the mission and strategic plan;
- financial information related to the NFP's liquidity and financial position;
- reserves activity, compliance with donor restrictions, endowment activity, and other investment information;
- hotline calls and their disposition and other significant issues affecting internal controls
- general IT controls affecting access to and protection of organizational information, and
- fundraising efforts.

Boards with standing audit, finance, and investment committees, should look to those committees for more in-depth expertise. Delegation of oversight to a particular committee, does not, however, relieve the entire board of its responsibility for financial oversight.

## *Liability Issues*

Just as board members must understand their responsibilities, they should also understand the consequences of failing to meet those responsibilities. While the law recognizes and accepts that board members may not always be correct in their choices or decisions, it generally holds them accountable for being attentive, diligent, and thoughtful in considering and acting on a policy, course of action, or other decision.

A board member's failure to meet her/his responsibilities can directly impact the individual as well as the organization. The consequences can include: financial penalties, reputational damage, and legal action.

While it cannot repair an NFP's damaged reputation, directors and officers insurance (D&O) provides some protection against a breach of duty by the directors and officers. D&O insurance generally includes coverage for any actual or alleged act or omission, error, misstatement, misleading statement, neglect or breach of duty by board members in the discharge of their duties. It is important to note here that most insurance policies for members of the board of directors of a nonprofit do not cover those board members when they are deemed to have been negligent in carrying out their board responsibilities. In those cases where board members are found to be negligent (for example, by not exercising enough financial oversight of a nonprofit), they could be held personally liable for significant penalties and fines.

## Conclusion

High-performing boards are run by individuals who are informed and active in overseeing the organization's operations and finances. There are potential legal consequences to directors who fail to fulfill their basic responsibilities. If you serve on a board, ask for information to help you fulfill your responsibilities. Larger organizations typically offer an orientation for new board members. If your organization does not provide such an orientation, make sure all your questions are answered and informative documents provided, so that you understand the entity and its environment. Ask for timely financial reports and metrics related to programs so that performance can be assessed. Strong oversight by those charged with governance of an NFP is imperative to maintaining the public's trust. If you serve on a board, it is your duty and right to be informed to the extent necessary to make sound decisions.