



Best Practice Considerations When Serving on the Board of a Nonprofit Organization

You should consult this memorandum if you either currently serve on the board of directors of a nonprofit organization or have been asked to serve. This memorandum includes a detailed checklist of best practices to consider when evaluating the governance and operations of your organization.

Under U.S. tax law, most tax exempt organizations are required to file an annual tax return known as a Form 990. In recent years, the IRS has become very active in using the Form 990 to push tax exempt organizations to adopt certain “best practices” in corporate governance. Lacking clear authority to regulate the internal governance of state chartered organizations, the IRS has instead adopted an approach of “regulation through disclosure.” Many of the questions raised in this memo are derived from actual questions that the organization must answer when completing its Form 990 filings.

The corporate governance questions raised by the IRS in the Form 990 do not actually create new federal mandates for nonprofit organizations; rather, the disclosures required by the Form 990 provide information that is of interest to other constituents (e.g., donors, state attorneys general, lenders, rating agencies, competing organizations, etc.). A failure to live up to the “best practice” expectations of these other constituents could have an adverse impact on your organization.

Please note that this memo provides a general framework in which to analyze your organization’s governance controls. It is not intended to be an exhaustive list of corporate governance issues and each nonprofit organization has its own unique circumstances and organizational considerations. Accordingly, every governance policy addressed in this memo is not necessarily appropriate for your organization and there may be other policies and procedures that your organization should consider which are not addressed in this memo.

This memo is not intended to constitute legal advice. You should consult the attorney representing your nonprofit organization for specific guidance. If you think that your organization could benefit from a confidential governance audit, please contact either of the members of Morris, Manning & Martin, LLP’s Exempt Organizations Practice listed below:



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I. Preliminary Diligence Matters

1. Have you reviewed the organization's Form 990s for the past several years (see www2.Guidestar.org)?
2. Does the organization have a written Mission Statement? Does the Board review and update the Mission Statement each year?
3. Does the organization have a written business or strategic plan that is consistent with its Mission Statement?
4. Does the organization have a policy (written or otherwise) regarding personal financial contributions by Board members? Please note that the BoardSource Nonprofit Index 2007 indicates that Boards average 74% participation in giving, 46% of charities have 100% participation in giving and 68% of charities require board members to make personal financial contributions.

II. Board Composition and Operation

1. Have the members of the Board of Directors been educated about the fiduciary duties (e.g., Duty of Care and Duty of Loyalty) that they owe to the organization?

Briefly, the Duty of Care requires the director to act with the care an ordinarily prudent person in a like position would exercise under similar circumstances. The Duty of Loyalty requires the director to act in a manner that the director reasonably believes in good faith to be in the best interests of the organization. The Duty of Loyalty also covers conflict of interest situations, generally requiring, at a minimum, the disclosure of the potential conflict and nonparticipation of the conflicted director in the actions taken by the organization with regard to the conflict situation.

2. Does the organization have an Executive Committee and if so, is there a written charter for the committee? Is the Executive Director or other key employee a member of that committee, with full voting rights?
3. Do the organization's Bylaws require that a certain number of directors be independent? Is there a nominating committee that ensures compliance with any director independence requirements?
4. Does the Board include "independent directors" and if so, how many? To be considered independent, the director must satisfy each of the following criteria during the entirety of the organization's tax year:
 - (i) The director was not compensated as an officer or other employee of the organization or of a related organization (note that there is a narrow and specific exception for compensation received from religious organizations);
 - (ii) The director did not receive total compensation or other payments exceeding \$10,000 as an independent contractor during the tax year from the organization or a related organization; and

(iii) Neither the director nor any member of the director's family was involved in a transaction required to be disclosed on Schedule L (disclosing certain relationships or transactions with interested persons and relating to excess benefits, loans, grants or other financial assistance and other financial or business transactions or arrangements).

5. Does the organization's Board reflect diversity, whether measured by race, gender, age, religion, employment experience or other appropriate measurements?
6. Is the Executive Director or other key employee a member of the Board and if so, does he/she have full voting rights and what position on the Board does he/she hold? Please note that the BoardSource Nonprofit Index 2007 indicates that only 14% of nonprofit chief executives serve as voting members on their Board and only 4% are also the Board chair.
7. Does the Board meet in executive session (i.e., outside the presence of the organization's executive officers) on a regular basis?
8. Does the Board conduct periodic formal self-assessments, which include detailed written evaluations of the Board's qualifications, processes, actions and results?
9. Does the Board have reasonable access to the organization's officers, senior executive employees and professional advisors?
10. Does the organization provide the Board with relevant information far enough in advance of meetings to allow directors to make informed decisions?
11. Does the Board conduct periodic written performance evaluations of the organization's executive staff and are there written guidelines to maintain and strengthen the evaluation process from year to year?
12. Does the organization have a program or system in place to ensure that the Board and the organization's executive officers are informed and educated about material developments in the laws and regulations governing nonprofit organizations?

III. Financial and Tax Matters

1. Who is the organization's audit firm? Does the audit firm have specialized experience in tax and audit work for nonprofit organizations? How long has the organization worked with its current audit firm? Has the audit firm ever issued any management letters to the organization or otherwise documented any significant internal control issues?
2. Does the organization have a Form 990 Board Review Policy? Are designated members of the Board actively engaged in review of the organization's Form 990?
3. Does the organization have an Audit Committee? If so, is there a written audit committee charter?
4. Does the organization have procedures in place to ensure that its financial statistics (especially expense ratios) are in conformance with representations made in the organization's charitable solicitations?

5. Does the organization engage in “joint ventures” and other similar strategic partnerships? If so, does it have a written joint venture policy that is designed to safeguard the organization’s tax exempt status during its participation in the partnership?
6. Does the organization engage in any commercial, for-profit business activities (e.g., leasing space for private receptions or parties) which might give rise to unrelated business income?
7. Has the organization ever been audited or investigated by the IRS or any other governmental authority, and if so, what are the details and disposition of those audits?

IV. Miscellaneous Governance Policies

1. Does the organization have a written conflict of interest policy? If so, how does the organization regularly and consistently monitor and enforce compliance with the policy?
2. Does the organization have a written corporate ethics policy? If so, how does the organization regularly and consistently monitor and enforce compliance with the policy? Are the organization’s ethical standards emphasized within the organization, such that the standards have become part of the organization’s culture?
3. Does the organization have a written whistleblower policy and if so, how does the organization consistently enforce the policy?
4. Does the organization have a written record retention and destruction policy? If so, how does the organization regularly and consistently monitor and enforce compliance with the policy?
5. Does the organization have a written compensation policy? If so, how does the organization regularly and consistently monitor and enforce compliance with the policy?
6. Does the organization have a written gift acceptance policy and if so, how does the organization regularly and consistently monitor and enforce compliance with the policy?
7. Does the organization have a written fundraising policy to ensure compliance with state and federal law? Is the organization registered and qualified as a fundraiser in each state in which it is required to be registered as such?
8. Does the organization hold any conservation easements? If so, is there a written policy regarding monitoring, inspection and enforcement of the organization’s rights under such easements?
9. Are the organization’s governance policies published within the organization in a manner which ensures that all executives and employees are aware of and well educated about the policies?

V. Corporate Records and Documents

1. Does the company have a minute book and is it organized and complete?
2. Are all meetings of the Board members properly documented in minutes?
3. Are minutes circulated to members of the Board following each meeting?
4. Have you obtained and reviewed a copy of the Articles of Incorporation, Bylaws and past Board and member minutes? Consider maintaining a notebook or electronic record of these documents and updating your copies on an ongoing basis.
5. Have you reviewed the Bylaws to verify that the company is following proper procedure as outlined therein for conducting meetings, approving contracts, and taking other material corporate actions?

VI. Insurance and Indemnification

1. Does the organization have fulsome indemnification provisions in its applicable corporate documents (generally the bylaws and/or articles of incorporation) that have been updated to conform to any changes in applicable corporate law? Does the indemnification provide for advancement of expenses?
2. Does the organization provide indemnification agreements for directors and officers and if so, have all directors signed them?
3. Has the organization obtained directors and officers insurance and is the coverage appropriate given the current operations of the organization? Does the policy cover the costs of defense and liability? Have you obtained a summary of insurance coverage, limits, and confirmation of premium payments?
4. Have any claims or lawsuits been filed against the company? If so, what are the details of those claims, including potential exposure for the organization and members of the Board?

VII. Intellectual Property

1. Has the organization taken appropriate steps to protect its intellectual property, including service marks, trade names, logos, mottoes, and similar communications which distinguish the organization from its competitors? Does the organization have a policy or process for monitoring and maintaining its trademarks, copyrights and other intellectual property protections?
2. Have the organization's executives and key staff members entered into appropriate restrictive covenant agreements (e.g., non solicitation of employees and donors, non disclosure of trade secrets, work made for hire provisions, etc.) with the organization?

3. Is the organization in compliance with its software licenses (including limitations on the number of employees who can access and use the software) and is there a system to monitor and ensure continued compliance? Does the organization have licenses on all of the software that is used or useful in the organization's operations? Does the organization use open source software in its operations?
4. Does the organization own any intellectual property that is used by third parties, and if so, are licenses in full force and effect with respect to that intellectual property?
5. Has the organization ever been involved in a dispute over its own or a third party's intellectual property rights and if so, how was the dispute resolved?