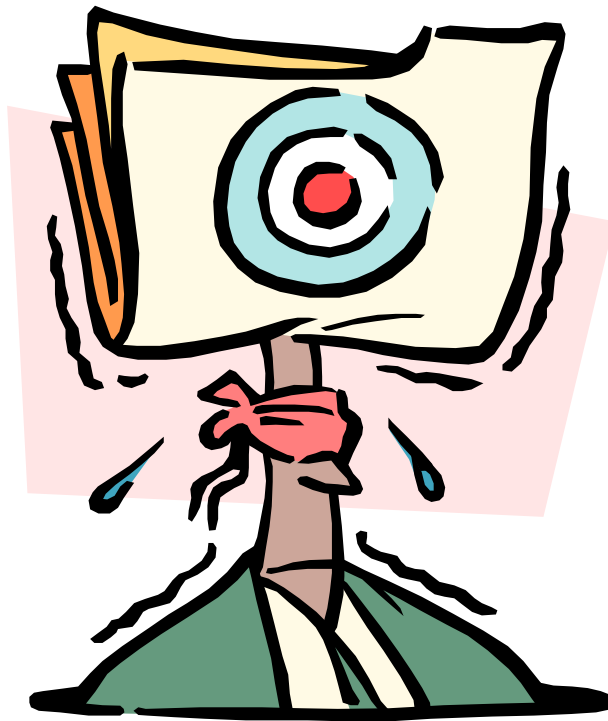


FIDUCIARY RESPONSIBILITY OF THE BOARD:

Duties of the Board Member in a Challenging Environment



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I. The Changing Environment for Nonprofit Organizations

A. IRS “Good Governance Practices” (incorporated in the new Form 990)

1. Mission statement
2. Organizational Documents
3. Governing Body (expertise, independence)
4. Executive Compensation (independent review)
5. Conflicts of Interest Policy
6. Investment Policy
7. Fundraising
8. Minutes/records
9. Document retention policy
10. Code of Ethics & Whistleblower Policy
11. Financial Statements & Form 990 Reporting
12. Transparency of operations and financial information to public

B. Sarbanes Oxley.

1. Requires **publicly traded companies** adhere to new governance standards that expand the role of directors in overseeing financial transactions and auditing procedures
2. Independent and competent audit committee, inclusion of financial expert on audit committee
3. Lead/reviewing partners of audit firm must rotate off audit every 5 years

4. Auditing firm prohibited from providing any non-auditing services unless board pre-approval
5. CEO and CFO must certify financial statements
6. Loans to directors and executives prohibited
7. “Real time” disclosure of material, financial events
8. Protection for whistle-blowers
9. Makes criminal the alteration, destruction, or falsification of documents.
10. Audit records must be retained for five years
11. Impact on Nonprofit Organizations
 - a. Auditing procedures need to be reviewed/updated
 - b. May establish new standards of “duty of care” for nonprofit directors
 - c. Change auditors or audit firms periodically
 - e. Executive Directors may have to sign off on financial matters
 - f. Document destruction policy
 - g. Insider transactions/conflicts of interest will be subject to higher degree of scrutiny
 - h. Boards will need to become more proactive

C. State Nonprofit Reform Initiatives/Investigations

1. California

2. New York

3. Others

D. External Interest Groups

1. Watchdogs (BBB, Charity Navigator)

2. Internal Revenue Service

3. Federal and State regulators

4. Members

5. Media

6. AICPA Statements on Auditing Standards (“SAS”)

7. Independent Sector Standards (www.independentsector.org)

8. Panel of the Nonprofit Sector (33 Principles in 4 main categories). See www.nonprofitpanel.org.

E. Scandals

1. Convention & Visitor Bureau Cases

2. Smithsonian Secretary/CEO

- a. Donated more than \$500,000 and raised \$1.1 billion

- b. Compensation was \$884,000 on the way to \$915,000

- c. Reimbursements included: \$152,000, utilities; \$273,000, housekeeping; \$4,000, pool repairs; charter jet trips

II. Duties of Board & Committee Members

A. Statutory Duty

1. Nonprofit Corporation Statutes:

"The affairs of a corporation shall be managed by a board of directors."

2. Standards of Conduct

"A director shall discharge the duties of the position as director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation." Model Revised Nonprofit Corporation Act, §8.30

B. Fiduciary Duties

1. Duty of Care - discharge duties in good faith and as an ordinarily prudent person in a like position would exercise under similar circumstances. Included in this is the duty to act in accordance with the organization's mission and applicable law.

2. Duty of Loyalty - act for the benefit or best interests of the corporation. Courts expect "undivided loyalty and allegiance." Concerns usually arise in connection with conflicts of interest and/or financial benefit.

a. Doing business with the association

b. Usurping a corporate opportunity (acquisition of property, exploiting educational materials or concepts)

- c. Competing with the association
 - d. Relationships with third parties
- 3. How to avoid a breach of the duty of loyalty
 - a. Disclosure
 - b. Abstention
 - c. Absence
 - d. Resignation

III. Areas of risk

- A. Conflicts of Interest
- B. Contracts
- C. Employment (i.e. interfering with staff; sexual harassment)
- D. Defamation
- E. Copyright
- F. Antitrust
 - 1. Areas of concern include pricing, territories, exclusion of competitors, division of services, disciplining members
 - 2. New enhanced federal penalties (\$100 million for corporations and \$1 million for individuals, ten years imprisonment)
- G. Tax/financial
- H. E-mail/cyberspace

IV. Ways to avoid/minimize risk for board members

A. Be informed

- * read organizational materials (articles, bylaws, etc.)
- * read and revise minutes
- * know your responsibilities and duties
- * be involved in deliberations
- * follow agenda
- * remember that minutes are open records
- * ask questions
- * seek expert opinions (legal, accounting) through the Executive Director or Chair. The board attorney represents the organization--- not Board members.
- * attend all meetings
- * come prepared to meetings
- * financial audits

B. Disclose all conflicts/abstain/absent from discussion

C. Avoid any self-dealing/usurp corporate opportunity/compete

D. Directors & Officers liability insurance

E. Monitor delegated activities (committees, panels, etc.)

F. Don't get involved in day-to-day management of Board employees. It is the Executive Director who hires and manages other employees. Any problems should be brought to the attention of the Executive Director. There may be employment problems you are not aware of.

Involvement may create additional liability for director or for association. Avoid even casual comments to or about employees. These can create problems too.

- G. Stay in touch with members
 - H. Be aware that when you speak you will be perceived as a Board member with authority to speak for the Board. Only the designated person (e.g. Chair, President) can speak for the organization.
 - I. Once the board has decided, stand behind the decision (duty of loyalty)
 - J. Maintain confidentiality. There are times when the Board goes into Executive Session (employment, budget, attorney client, disciplinary matters). These are confidential for a reason. To violate that confidentiality is a breach of fiduciary duty to the organization.
 - K. Do not discuss business practices of other members. There may be defamation or antitrust concerns
 - L. Be aware of statutory/organizational duties
 - M. Adopt policies for key areas (e.g., conflicts, audit, investment, whistleblower, document retention/destruction)
- V. Protection for Directors, Officers & Volunteers
- A. D & O insurance
 - B. Personal/homeowners insurance
 - C. Trained staff
 - D. Indemnification
 - 1. Indemnification - the obligation of one person to pay for the costs, expenses or damages for which another person becomes obligated to pay.

2. Articles of Incorporation and Bylaws

3. District of Columbia Code provides that:

"The corporation has the power to indemnify any director, or officer, or former director or officer of the corporation or any person who may have served at its request as a director or officer of another corporation...against expenses actually and necessarily incurred...in connection with the defense of any action, suit, or proceeding in which he is made a party by reason of being or having been such director or officer..." D.C. Code §29-301.05

Indemnification is not provided for matters in which the director or officer is held to be liable for negligence or misconduct in the performance of a duty.

E. Statutory Protection

1. District of Columbia Code provides immunity for directors, officers and volunteers.

“Any person who serves as a volunteer shall be **immune from civil liability** except where the injury or damages was the result of:

* willful misconduct;

* a crime (unless the volunteer had reasonable cause to believe the act was lawful);

* a transaction that resulted in an improper personal benefit of money, property or service to the volunteer;

* an act or omission prior to March 17, 1993; or

* an act or omission that is not in good faith and is beyond the scope of authority of the corporation.”

D.C. Code §29-301.113 (2004)

NOTE: In order for this immunity to apply, the corporation must maintain liability insurance with a coverage limit of no less than \$200,000 per individual claim and a \$500,000 per total claims that arise from the same occurrence.

2. Colorado Volunteer Service Act for Directors/Officers, C.R.S. ' 13-21-115.7.

Provides that any volunteer, director or officer is "immune from civil liability for any act or omission which results in damage or injury if such person is acting in good faith within the scope of such person's official functions and duties". This protection is not available if the injury was caused by "willful and wanton" acts. Moreover, the immunity does not apply to injuries resulting from the operation of a motor vehicle, airplane or boat.

3. Colorado Volunteer Service Act for Volunteers, C.R.S. ' 13-21-115.5.

Provides immunity for volunteers who are acting in good faith within the scope of such person's official functions and duties. Lawsuits involving motor vehicle are not precluded, but damages are limited to applicable insurance coverage of the volunteer.

4. Federal Volunteer Protection Act of 1997 limits liabilities for volunteers who act within the scope of their responsibility and, where required by state law, are licensed or certified. Injury must not have been caused by willful or criminal misconduct, gross negligence, reckless misconduct, and flagrant indifference. Does not cover those volunteers who receive over \$500 or items valued at over \$500.

VI. Conclusion

Overview of Form 990 (revised)

- A. Form 990 (Transparency, transparency, transparency)
 - 1. First reform in nearly 30 years
 - 2. Must be used for fiscal years that begin in 2008; those on calendar year basis will have to use by May 15, 2009
- B. Core form (11 sections) – to be filed by ALL organizations
 - 1. Summary (Part I) – mission, revenue/expense summary; number of volunteers; independent board members
 - 2. Signature (Part II) – allows IRS to discuss return with preparer
 - 3. Statement of Program Service Accomplishments (Part III) – three largest program services must be described
 - 4. Checklist of Required Schedules (Part IV) – 37 questions to determine how many of the 16 Schedules you get to file
 - 5. Statements Regarding Other IRS Filings (Part V) – have you filed other forms (employment, 1099s, etc.)
 - 6. Governance, Management & Disclosure (Part VI) – All new as to how the organization is structured, governed, policies and practices; how many directors, any independent directors, local chapter policies to ensure operation consistent with the filing organization’s tax exempt purpose
 - 7. Compensation of Officers, Directors, Key Employees (Part VII) - 5 highest paid employees AND independent contractors. Threshold is \$100,000 and over (however, must include an estimate of fringe benefits—retirement plans, health insurance, etc. Definition of “Key Employee” still awaiting clarification
 - 8. Statement of Revenue (Part VIII) – summary of all revenue streams

9. Statement of Functional Expenses (Part IX) – more detail concerning expenses.
10. Balance Sheet (Part X) – similar to current reporting
11. Financial Statements & Reporting (Part XI) – how are financial statements prepared? Are they compiled, reviewed or audited? Do you have an audit committee?

C. Sixteen (16) New Schedules

1. Schedule A – Public Charity Status & Support Test
2. Schedule B – Contributors (unchanged)
3. Schedule C - Political Campaign & Lobbying – combines prior questions and asks for detail on all political contributions---including those passed through to the organization’s own PAC
4. Schedule D – Supplemental Financial Statements
5. Schedule F – Statement of Activities Beyond the United States
6. Schedule J – Compensation Information –extension of Part VII of the Cover Form; wants detail on executive perks (compensation policies and arrangements) for employees with more than \$150,000 (per W-2 or 1099) or \$250,000 in total compensation including fringe benefits
7. Schedule L – Transactions with Interested Persons – seeks details of business dealings, loans and other transactions between association and its officers, directors or executives
8. Schedule O – Supplemental Information (additional 2 pages for each question and additional two pages for any other information)
9. Schedule R – Related Organizations – requests information on “Disregarded Entities.”

D. New Instructions

1. Comment period ended June 1, 2008
2. Definition of “Independent Board member”
3. Reporting of Compensation Paid to Management Companies
4. Definition of “Key Employee”
 - a. The term “discrete” generally hard to apply to 501(c)(6)
 - b. “Manage” does not equal “control.”
 - c. 5% threshold for control – too much of a stretch

E. A Blessing or Curse in Disguise?

1. Nonprofit boards must be more engaged
2. Only 50% of organizations have any conflict of interest policy
3. Transparency for the public
4. Outside audits
5. Review of the Form 990 by the governing body

F. Smaller nonprofits (less than \$25,000 in gross receipts) will now have to file Form 990-N (postcard) unless part of a group exemption, private foundation or supporting organization which files 990 or 990-EZ

Tips to Assist in Prevention of Fraud/Embezzlement

1. Cash larceny (cash stolen before recorded; cash from one account applied to another; false statements showing payment)
2. Check tampering (counterfeit, forgery, unauthorized checks, misdeposit)
3. Billing schemes (fraudulent invoices, shell company, ghost employees, paying for non-existent goods)
4. Improved accounting procedures
 - a. Segregate cash related functions (receipt/disbursement of funds; check signing; reconciliation of accounts)
 - b. Multiple/separate signatures on checks
 - c. Only pay against invoice/attach invoice to check stubs
 - d. Verify payroll account
 - e. Have monthly bank statements delivered sealed to separate person
 - f. Periodic review of cash accounts/bank statements
 - g. Provide for reporting mechanism by employees
 - h. Observe changes (employee living beyond means; change in bidding procedures; payments to company in which employee has interest)
5. Outside audits
6. Review/Change of auditors
7. Encourage vacations

SAMPLE FORMS¹

1. **Code of Ethics for Board Members**
2. **Document Retention**
3. **Whistleblower**
4. **Audit Committee Role & Responsibilities**

I. Code of Ethics for Board Members

Goal: To establish a set of principles and practices of the {Name of Organization} Board of Directors that will set parameters and provide guidance and direction for board conduct and decision-making.

Code: Members of the Board of Directors of the {Name of Organization} are committed to observing and promoting the highest standards of ethical conduct in the performance of their responsibilities on the board of {Name of Organization}. Board members pledge to accept this code as a minimum guideline for ethical conduct and shall:

Accountability

1. Faithfully abide by the Articles of Incorporation, by-laws and policies of {Name of Organization}.
2. Exercise reasonable care, good faith and due diligence in organizational affairs.
3. Fully disclose, at the earliest opportunity, information that may result in a perceived or actual conflict of interest.

¹ The sample forms which follow are authorized for non-commercial use by nonprofit organizations with the following attribution: Copyright 2004, National Council of Nonprofit Associations, www.ncna.org.

The National Council of Nonprofit Associations (NCNA) is the network of state and regional nonprofit associations serving over 22,000 members in 46 states and the District of Columbia. NCNA links local organizations to a national audience through state associations and helps small and mid-sized nonprofits: manage and lead more effectively; collaborate and exchange solutions; save money through group buying opportunities; engage in critical policy issues affecting the sector; and achieve greater impact in their communities.

4. Fully disclose, at the earliest opportunity, information of fact that would have significance in board decision-making.
5. Remain accountable for prudent fiscal management to association members, the board, and nonprofit sector, and where applicable, to government and funding bodies.

Professional Excellence

1. Maintain a professional level of courtesy, respect, and objectivity in all {Name of Organization} activities
2. Strive to uphold those practices and assist other {Name of Organization} members of the board in upholding the highest standards of conduct

II. Personal Gain

1. Exercise the powers invested for the good of all members of the organization rather than for his or her personal benefit, or that of the nonprofit they represent.

A. Equal Opportunity

1. Ensure the right of all association members to appropriate and effective services without discrimination on the basis of geography, political, religious, or socio-economical characteristics of the state or region represented.
2. Ensure the right of all association members to appropriate and effective services without discrimination on the basis of the organization's volunteer or staff make-up in respect to gender, sexual orientation, national origin, race, religion, age, political affiliation or disability, in accordance with all applicable legal and regulatory requirements.

III. Confidential Information

Respect the confidentiality of sensitive information known due to board service.

IV. Collaboration and Cooperation

1. Respect the diversity of opinions as expressed or acted upon by the {Name of Organization} board, committees and membership, and formally register dissent as appropriate.
2. Promote collaboration, cooperation, and partnership among association members.

Document Destruction

The Sarbanes-Oxley Act addresses the destruction of business records and documents and turns intentional document destruction into a process that must be carefully monitored.

Nonprofit organizations should have a written, mandatory document retention and periodic destruction policy. Policies such as this will eliminate accidental or innocent destruction. In addition, it is important for administrative personnel to know the length of time records should be retained to be in compliance.

The following table provides the minimum requirements.

This information is provided as guidance in determining your organization's document retention policy.

Type of Document	Minimum Requirement
Accounts payable ledgers and schedules	7 years
Audit reports	Permanently
Bank Reconciliations	2 years
Bank statements	3 years
Checks (for important payments and purchases)	Permanently
Contracts, mortgages, notes and leases (expired)	7 years
Contracts (still in effect)	Permanently
Correspondence (general)	2 years
Correspondence (legal and important matters)	Permanently
Correspondence (with customers and vendors)	2 years
Deeds, mortgages, and bills of sale	Permanently
Depreciation Schedules	Permanently
Duplicate deposit slips	2 years
Employment applications	3 years
Expense Analyses/expense distribution schedules	7 years
Year End Financial Statements	Permanently
Insurance Policies (expired)	3 years
Insurance records, current accident reports, claims, policies, etc.	Permanently
Internal audit reports	3 years
Inventories of products, materials, and supplies	7 years
Invoices (to customers, from vendors)	7 years
Minute books, bylaws and charter	Permanently
Patents and related Papers	Permanently
Payroll records and summaries	7 years
Personnel files (terminated employees)	7 years
Retirement and pension records	Permanently
Tax returns and worksheets	Permanently
Timesheets	7 years
Trademark registrations and copyrights	Permanently
Withholding tax statements	7 years

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Sample Whistleblower Policy

General

{organization name} (Organization) Code of Ethics and Conduct (“Code”) requires directors, officers and employees to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. As employees and representatives of the Organization, we must practice honesty and integrity in fulfilling our responsibilities and comply with all applicable laws and regulations.

Reporting Responsibility

It is the responsibility of all directors, officers and employees to comply with the Code and to report violations or suspected violations in accordance with this Whistleblower Policy.

No Retaliation

No director, officer or employee who in good faith reports a violation of the Code shall suffer harassment, retaliation or adverse employment consequence. An employee who retaliates against someone who has reported a violation in good faith is subject to discipline up to and including termination of employment. This Whistleblower Policy is intended to encourage and enable employees and others to raise serious concerns within the Organization prior to seeking resolution outside the Organization.

Reporting Violations

The Code addresses the Organization’s open door policy and suggests that employees share their questions, concerns, suggestions or complaints with someone who can address them properly. In most cases, an employee’s supervisor is in the best position to address an area of concern. However, if you are not comfortable speaking with your supervisor or you are not satisfied with your supervisor’s response, you are encouraged to speak with someone in the Human Resources Department or anyone in management whom you are comfortable in approaching. Supervisors and managers are required to report suspected violations of the Code of Conduct to the Organization’s Compliance Officer, who has specific and exclusive responsibility to investigate all reported violations. For suspected fraud, or when you are not satisfied or uncomfortable with following the Organization’s open door policy, individuals should contact the Organization’s Compliance Officer directly.

Compliance Officer

The Organization’s Compliance Officer is responsible for investigating and resolving all reported complaints and allegations concerning violations of the Code and, at his discretion, shall advise the Executive Director and/or the audit committee. The Compliance Officer has direct access to the audit committee of the board of directors and is required to report to the audit committee at least annually on compliance activity. The Organization’s Compliance Officer is the chair of the audit committee.

Accounting and Auditing Matters

The audit committee of the board of directors shall address all reported concerns or complaints regarding corporate accounting practices, internal controls or auditing. The Compliance Officer shall immediately notify the audit committee of any such complaint and work with the committee until the matter is resolved.

Acting in Good Faith

Anyone filing a complaint concerning a violation or suspected violation of the Code must be acting in good faith and have reasonable grounds for believing the information disclosed indicates a violation of the Code. Any allegations that prove not to be substantiated and which prove to have been made maliciously or knowingly to be false will be viewed as a serious disciplinary offense.

Confidentiality

Violations or suspected violations may be submitted on a confidential basis by the complainant or may be submitted anonymously. Reports of violations or suspected violations will be kept confidential to the extent possible, consistent with the need to conduct an adequate investigation.

Handling of Reported Violations

The Compliance Officer will notify the sender and acknowledge receipt of the reported violation or suspected violation within five business days. All reports will be promptly investigated and appropriate corrective action will be taken if warranted by the investigation.

Audit Committee Compliance Officer

{organization name} Management Staff

Audit Committee

Role and Responsibilities

This Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities. Duties of the committee include:

- overseeing the integrity of the Corporation's financial accounting process and systems of internal controls regarding finance, accounting and use of assets;
- overseeing the independence and performance of the independent auditors and staff with finance responsibilities;
- overseeing the operation of the policies on conflicts of interest and the Corporation's board-staff communications;
- providing an avenue of communication among the Corporation's independent auditors, management, staff, and the Board of Directors.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors as well as to anyone in the organization. The Audit Committee has the authority to retain, at the Corporation's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

The Audit Committee shall be comprised of five members, three from the board and two from the state association network or qualified individuals. All members of the Audit Committee shall be independent non-staff directors, free from any relationship that would interfere with the exercise of his or her independent judgment.

The specific activities of the Audit Committee are outlined in the document titled "Checklist."