Agenda

• Governance Basics
  – Legal Framework
  – Fiduciary Duties
  – Board Challenges
  – Role of Best Practices

• Asking the Tough Questions
  – Why directors need to inquire
  – When directors should inquire
  – Red flags that signal the need for inquiry
Agenda (continued)

- Preventative Measures
  - Mission
  - Board Meetings
  - Procedures and Controls
- Part II: Policies and Checklists
Growing Demands on Boards

- Heightened need for attention to governance structures & processes
  - Risk management
  - Credit & liquidity issues
  - Succession planning
  - Relations with stakeholders: communication & engagement
Growing Demands on Boards (continued)

• Appreciation that end-game is the mission
  – Compliance is necessary but not sufficient
• Focus on the long-term
Legal Framework: Sources of Corporate Governance Rules

• Federal Tax Law
  – Exempt organization rules
  – Revised Form 990 governance disclosure
• State Law
  – Specific not-for-profit/nonstock corporation law
  – UPMIFA
• “Best Practices”
IRS Impact on Governance

• Form 990: Increased regulation of governance – an area traditionally regulated by state law
• Goal is to strongly encourage, by disclosure, the implementation of “good corporate governance” policies and provide the IRS the ability to better identify abusive transactions
IRS Impact on Governance (continued)

• New sections require more disclosures in what IRS considers “Hot Spots” in order to curtail abuses
  – Organizational Governance
  – Compensation
  – Fundraising Activities
  – Related Organizations
Board State Law Duties

- **Duty of care**: Act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- **Duty of loyalty**: Act in good faith in a manner the director reasonably believes to be in the best interests of the organization.
- **Duty of obedience**: Act within the organization's purposes to further the mission of the organization.
- **Prudent management of funds**: Manage and invest funds prudently and in good faith.
Board Responsibilities

Consistent with Fiduciary Duties

• Select, monitor, evaluate, compensate & replace (when necessary) senior management
• Review & approve strategic/long-term plans, consistent with mission
• Monitor corporate performance against plans
• Review & approve material capital allocations, budgets, financial standards and policies
Board Responsibilities (continued)

Consistent with Fiduciary Duties

- Ensure financial control & reporting integrity, ethical standards and legal compliance
- Oversee the audit
- Monitor & balance constituent relations
- Assist in fundraising
- Organize the work of the board
Board Challenges re Legal Obligations

- Understand & remain faithful to the mission
- Establish clear lines of authority (including line between board and management)
- Monitor & measure performance
  - Senior management team
  - Entity
- Protect assets:
  - “Follow the money” & internal controls
- Determine board structure, focus, & information
Role of Governance “Best Practices”

“Best Practices” help ensure that legal obligations are met by promoting active fiduciary oversight and objective and informed judgment.

Tools:
- Common understanding of mission
- Agreed strategies/plans/goals & metrics to measure progress
- Clear delineation of roles and authority for
  - board
  - management
  - members
  - volunteers
• Clear bylaws, board guidelines and policies
• Regular performance evaluation of management and directors
• Board refreshment
• Identification of agenda issues and information needs
Tone at the Top & Governing Style

- Strategic thinking; not administrating
- Future focused; not historic-looking
- Anticipatory; not reactive
- Collegial and diverse; not divisive
- Consensus-oriented; not “majority rule”
- Conflict-avoiding (and disclosing)
- Role clarity
Questions for Board Members to Ask

1. Am I passionate about the mission?
2. Do I understand the NFP’s financial health?
3. Do I understand my duties as a board member?
4. Do I understand other expectations (give or get)?
5. What are the risks?
6. What are my protections?
7. What is the culture? (ethics and integrity)
8. How engaged is the board?
9. Am I able to commit the time, attention and other resources required?
Board and Management Relationship

• Directors direct -- Executives execute
• Board promotes:
  – Active oversight
  – Objective and informed judgment
  – Nose in – fingers out = “NIFO”
  – Constructive tension
• Senior management should report to board on:
  – Appropriate financial and mission achievement reporting
  – Adequate financial controls
  – Appropriate policies regarding ethical standards and legal compliance
Why Directors Need to Inquire

- Component of an effective corporate compliance program
- Board of directors fiduciary responsibility—i.e., duty to investigate and take remedial actions
- Mitigation of possible criminal and civil liability exposure stemming from underlying corporate conduct
- The old adage that a good offense is at times the best defense
Purpose of Inquiries by the Board

- Board needs to understand and diagnose problems within the organization
- Frequently used to help avoid or limit liability and correct significant problems
- Usual catalysts include:
  - auditor report
  - compliance audits
  - insider allegations (whistleblowers)
  - government investigations, tax audit
When to Inquire

• Not every potential issue requires board inquiry
• Some issues are clear red flags; some are not
  – Specific allegation of material fraud is a red flag that merits board inquiry
  – Anonymous comment on a blog criticizing management is not
• Exercising judgment about when to inquire and what to inquire about is a major component of fiduciary duties
Red Flag Issues That Merit Inquiry

• Established media reports
  – Board must be attentive to credible media reports, but does not need to police every blog and comment on the internet for potential criticisms of the organization

• Auditor concerns/resignations
• Sudden resignation of key individuals
• Sudden, dramatic, and unexplained change in revenues/expenses
Accounting Review

• Should focus on allegations and commonly found “red flags” in the industry and/or jurisdiction
• Value in accounting review is review of internal controls
  – Preparation of a roadmap to provide detailed guidance to management in improving controls
  – Company’s improvements in controls/processes in place to prevent recurrence
Preventative Measures

• Conflicts Policy
• Compensation Procedures
• Internal Controls
• Board Practices at Meetings
• Focus on the Mission
Conflicts of Interest

- Elements of a Conflict Policy
  - What counts as a conflict? Potential conflict?
    - A competing interest; appears to affect objectivity or independence
    - Indirect conflicts
      - Disclose
      - Recuse
Conflicts of Interest

• Proceed only after certain determinations are made:
  – Consider alternatives
  – Best interests of organization
  – Permitted by state and tax law
  – Can be managed
Conflicts of Interest (continued)

- Applying the policy
  - Promulgation
  - Annual certifications
  - Prior disclosure vs. finding out later
  - Document compliance with policy
Prudent Management of Funds

• Have a written Investment Policy Statement
  – Clearly delegate management and investment functions
  – Consider factors such as inflation, taxes, expected total return, need to make distributions, any special value to mission
  – Make investment decisions in context of entire portfolio with reasonable risk and return objectives
  – Diversify unless there is a good reason not to
  – Promptly execute decisions and rebalance
Prudent Management of Funds (continued)

- Delegation of Management and Investment Functions to an Agent
  - Check gift instrument
  - Assess independence and freedom from conflicts of interest
  - Scope and terms of delegation
  - Monitor performance and compliance
  - Not liable for actions of properly engaged agent
Checklist for New Directors

• Provide book of basic documents
  – Certificate of incorporation, bylaws
  – Committee charters, committee assignment chart
  – Board guidelines, conflict and other key policies
  – Recent Form 990 and financials
  – Copies or summary of key grant or donor agreements
  – Organization chart and contact list

• Assign board mentor
• Determine and assign appropriate committee duties
Checklist for Every Board Meeting

• Distribute proper notice and board materials in advance; materials usually include:
  – agenda
  – minutes from last meeting
  – reports from management and committees
  – financials
  – proposed resolutions
• Determine proper quorum under state law and charter/bylaws.
• Are any conflict arrangements being considered? If so, confirm who is an interested director and that conflict policy is followed.
• Take minutes that document attendance, recusals, dissentions, discussion and bases for important votes.
Checklist for Meeting Minutes

• Document use of conflicts of interest policy.
• Show that the board used a thoughtful, deliberate and informed process to make important decisions.
• Document any advice given to the board by outside professionals such as counsel or accountants.
• Document any written materials provided in connection with an important decision (e.g., draft agreements, reports by management or advisors).
• Need not identify specific comments by specific directors; instead, the general nature of the board discussion should be reflected.
• Distribute a draft of the minutes to the meeting participants very soon after the meeting; do not wait until preparation for next meeting.
Checklist for Regular Board Meetings

- Review financials (especially budget variances, liquidity projections).
- Receive committee and management reports; follow up on delegations of authority by scheduling a report on progress to the full board.
- Receive periodic management reports of status and results of operations, mission achievements.
Checklist for Annual Board Tasks

• Oversee audit (can be delegated to Audit Committee)
• Review and accept accountant’s/auditor’s report (best by full board).
• Review and approve CEO and other officer compensation using rebuttable presumption procedures (best by full board; may be delegated to committee)
• Review and approve budget in advance.
• Evaluate investment portfolio performance, managers and policy.
• Distribute, collect and review conflict questionnaires.
Checklist for Annual Board Tasks (continued)

• Elect directors (consider if by separate member meeting and check any staggering requirements).
• Elect officers.
• Review Form 990.
• Appoint outside auditor for next year (can be delegated to Audit Committee).
Checklist for Occasional (2-5 years) Board or Committee Tasks

- Review and approve strategic and long-term plans.
- Consider board refreshment tools: age and term limits, rigorous self-evaluation.
- Plan for succession of directors and officers.
- Evaluate governance and policy documents.
- Evaluate committees: structure, charters, authority, membership and chairmanship.
- Review and revise mission statement (reflecting changes in charter and Form 990 as needed).


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