



BOARD GOVERNANCE *BEST PRACTICES IN MEMBER RESPONSIBILITIES - PART 1*

Nonprofits in this country have a huge impact on the people they serve and on our economy. In most other countries, the local government plays a greater role in providing the services that nonprofits provide here. For that reason, it is vital we all be aware of how these organizations are governed. After all, they spend billions of dollars to provide housing, education, health and human services, arts and culture to men, women and children all over the world.

Those who take responsibility for leading and administering these organizations, and the many who volunteer, often do so without pay or personal benefit, their sole reward being in helping the organization fulfill its mission.

Before joining the board of a not-for-profit, there are issues to be considered, questions to be asked, research to be done. In this first part of a two article series on board governance, we take a look at this process.

As a prospective board member, it is essential you do the following:

- ★ Understand the organization's mission, learn about its programs, read its publications, visit its program sites, look at its website and talk to key staff and major donors. Find out about its reputation in the community.
- ★ Obtain a current list of board and committee members and ask about expectations of board members.
- ★ Review the organizational chart to understand the accountability structure of the organization. Find out the backgrounds of key management.
- ★ Find out what committees the board has established and decide which (if any) to join.
- ★ Read the organization's certificate of incorporation, application for federal income tax exemption, by-laws and board and committee minutes to learn about its stated purposes, activities and concerns.
- ★ Review the organization's Internal Revenue Service (IRS) Form 990 or 990 PF and audited financial statements as well as its current internal financial reports to learn how its assets are used and to evaluate its financial health. Is the auditor's report on its financial statements unqualified? Has the auditor sent the organization a management letter? Has the IRS recently audited the organization? What does its report say?
- ★ Find out if the organization is required to register with the State Charities Bureau and, if so, whether it has registered and filed all required reports. Evaluate whether the filings, audit reports and other compliance requirements appear to be completed on a timely basis. Find out whether

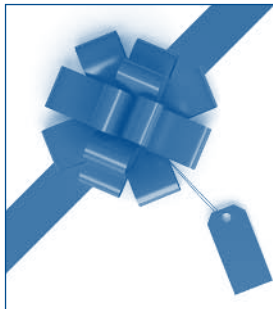
there are any tax issues or concerns (including payroll, sales and unrelated business income) or notices received from governmental authorities.

- ★ Obtain an understanding of the internal control structure of the organization and the processes in place to monitor it. Determine whether there is a current accounting policies and procedures manual that is followed. Review past management letters as well as any other communication with "those charged with governance" received from the public accountants and find out what has been done to remedy any problems identified.
- ★ Make sure there is an annually updated conflict of interest and code of ethics policy in place.
- ★ Learn about the reputation and past performance of the organization's auditors.
- ★ Find out if materials to be considered by the board or its committees are distributed in advance of meetings and whether they provide sufficient information necessary to be part of the stewardship process.
- ★ Obtain the current year's budget and cash flow projections. Find out how they compare to actual income and expenses and what processes are in place to monitor these comparisons.
- ★ Determine whether the insurance coverage is appropriate, including directors' and officers' liability and employee fidelity insurance to guard against embezzlement.
- ★ Consider the time required of a board member, since members who join a board without sufficient time to devote to its business are often at the root of troubles faced by boards.
- ★ Learn what training (if any) is provided to the board.
- ★ Understand any responsibilities for fundraising, personal giving commitments and other functions expected of board members, and decline any invitations to join if you know you would be unable to fulfill the commitments.

You are to be commended for wanting to join the board of a not-for-profit so that you can help a worthy organization make a difference. Go in with your eyes wide open, though, so that there are no surprises — for you or for the organization.

Look for Part II of this series on board governance in our Summer 2010 issue of Nonprofit Advisor, where we discuss some of the specific duties of board members in carrying out their fiduciary responsibilities.

Source: New York State Department of Law, Charities Bureau, "Right from the Start Responsibilities of Directors and Officers of Not-for-Profit Corporations"



THE GIFT ACCEPTANCE POLICY

WHAT IS IT AND WHY DOES YOUR ORGANIZATION NEED IT?

Adopting, implementing and monitoring sound governance policies to accomplish an organization's mission continue to be at the forefront of issues of concern to the nonprofit community. Even implementing just the basic policies encourages operational and managerial efficiency.

By now, most organizations have completed the inaugural filing cycle of the new Form 990 and are familiar with the "Governance, Management and Disclosure" section, which addresses the existence or lack thereof of policies, including conflicts of interest, whistleblower, document retention and destruction, joint ventures, review of the 990 and executive compensation.

Organizations required to file Schedule M for non-cash contributions have also been confronted with the question concerning the Gift Acceptance Policy (GAP).

Please note that it is critical to implement GAPs regardless of whether your organization receives non-cash or non-standard contributions. (See sidebar for definition of non-standard contributions.)

The value of implementing a written GAP lies in its practical application to provide guidelines and standards to evaluate acceptance of any type of gift.

Although it may seem counter-intuitive, some potential gifts would serve an organization better if they are refused!

A properly thought-out GAP helps the recipient organization identify both acceptable and unacceptable gifts. To simplify, an unacceptable gift potentially includes hidden costs that could be overlooked without the evaluation process, burdening and draining the accepting organization of resources that could be used either to develop other resources or support the mission.

A cautionary example of failure to implement an effective GAP involves an organization that accepted the donation of a yacht. The recipient organization did not perform any due diligence prior to acceptance, and ultimately, the resources (time, energy, expense) expended to execute the asset sale far exceeded the net proceeds received at the end of a long and circuitous process.

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As with the implementation of any of the other recommended policies, the expectation is that the adoption of a GAP will result in increased operational and managerial efficiency. Therefore, the goal of this article is to encourage organizations to consider implementing a GAP.

The written policy should incorporate the following aspects:

- ◆ **Mission of the organization – keep the organization's goals in mind**
- ◆ **Purpose of the policy – the purpose should be clearly stated**
- ◆ **Use of legal counsel by either the donor or the organization – identify circumstances when an attorney should be consulted**
- ◆ **Donor conflicts of interest – identify circumstances when the donor should seek professional advice prior to making a gift**
- ◆ **Restricted gifts – identify types of acceptable restrictions**
- ◆ **Gift acceptance committee – identify individuals with appropriate expertise and experience to make decisions**

- ◆ **Type and form of gift – identify each type of gift and acceptable forms**
- ◆ **Reporting requirements – for example: acknowledgement of gifts, IRS forms**
- ◆ **Monitoring – review policy regularly**

The adoption of a GAP should be a coordinated effort between the planned giving or development officers, executive personnel and designated board members in conjunction with professional advisors.

A well-executed GAP provides flexibility, both in evaluating potential gifts, and within the document, providing for future amendments to "grow" with the organization's planned giving office, while meeting the current need for providing discipline and education as well as preserving donor relationships.

Even if your organization is small with limited resources, there are resources available to minimize the cost to implement a GAP. The Board Source (www.boardsource.org) offers a plethora of resources including [The Nonprofit Policy Sampler](#), which includes hundreds of sample policies that can be individually purchased and downloaded electronically for a very modest cost.

The adoption of a GAP will contribute immeasurable value to the organization and have a long-lasting impact on the governance of not-for-profit organizations.

NON-STANDARD CONTRIBUTIONS

The Internal Revenue Service defines a non-standard contribution as the contribution of an item that is not reasonably expected to be used to satisfy or further the organization's exempt purpose and for which (a) there is no ready market to liquidate the donation to convert it to cash and (b) the value of the item is difficult to ascertain or speculative.

THE ROLE OF THE COMPENSATION COMMITTEE

We are seeing significant growth in the number of not-for-profit boards that have a specialist Compensation Committee to oversee executive compensation.

In recent years there has been increased scrutiny on executive compensation not only in the for-profit sector, but also in not-for-profit organizations. Given this environment, it is even more critical that pay decisions are carefully considered and well documented. In response, not-for-profit industry leaders are adopting more rigorous review processes and delegating close oversight of compensation to Board committees.

IRS reporting requirements relate to highly compensated employees and “disqualified persons” who are key employees with responsibilities, powers or influence over the organization as a whole. If an organization meets the following three requirements, it establishes a rebuttable presumption that payments to a “disqualified person” under a compensation arrangement are reasonable:

- ✓ *The compensation arrangement must be approved in advance by an authorized body of the tax-exempt organization, which is composed of individuals who do not have a conflict of interest concerning the transaction,*
- ✓ *Prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability, and*
- ✓ *The authorized body adequately and timely documented the basis for its determination concurrently with making that determination.*

The final regulations for the new IRS form 990 outline the documentation requirements for decisions regarding executive compensation. These guidelines refer to an “authorized body” charged with documenting the terms of the transaction, including the date it was approved, comparability data relied upon, conflicts of interest and Board members who voted on the transaction.

The Board of Directors holds final authority for establishing the compensation of the Chief Executive Officer (CEO) and approving the compensation ranges for

other executives. However, as a matter of practicality, many Boards of Directors delegate to a committee the responsibility for evaluating and recommending changes in compensation for “disqualified persons” who are executives of an organization. While sometimes this body is the Executive Committee, more frequently the responsibility is delegated to a Compensation Committee.

A smaller subset of the Board is more agile in its ability to meet and make decisions, and while the Executive Committee also meets this criterion, it may not have the appropriate mix of members. A Compensation Committee typically consists of at least three members and usually includes the Treasurer. All members should be independent directors with no interests or conflicts that might influence their actions. To fully comprehend executive compensation arrangements, it is desirable to have a knowledgeable, dedicated committee with specific oversight and monitoring responsibilities. For very large organizations, one non-voting Compensation Committee member with expertise in compensation may be recruited.

Typical committee responsibilities include the following:

- ✓ *Compensation Strategy – Establish the overall compensation philosophy and determine the target relationship of base salaries and total compensation to the relevant competitive market.*
- ✓ *Compensation Mix – Determine the elements that will comprise total compensation, including base salary, incentives, benefits and perquisites.*
- ✓ *Performance Goals – Establish organizational and individual performance goals for the CEO. Review the CEO's performance and recommend any compensation changes.*
- ✓ *Oversight – Monitor compensation provided to other executives to ensure compliance with the Intermediate Sanctions provisions of the Internal Revenue Code.*

- ✓ *Documentation - Prepare regular reports disclosing committee actions and recommendations to the full Board of Directors.*

Reports to the Board should meet the definition of “contemporaneous substantiation,” which means that actions should be taken within 60 days of the decision. This ensures the continued validity of the comparability data, and that actions are tied closely to the relevant review period. The report to the Board should provide a summary of the discussion by the Compensation Committee and refer to the materials on which decisions are based.

Among organizations with Compensation Committees, disclosure typically includes:

- ✓ *Advising the Board that a compensation review was conducted,*
- ✓ *Providing a summary of the conclusions identified in the compensation review,*
- ✓ *Providing documentation of the basis on which recommended changes to compensation were determined, and*
- ✓ *Highlighting the overall effect of the recommended changes on compensation – typically reported as a percentage change.*

With appropriate safeguards in place and clear lines of authority and responsibility, many not-for-profits are finding that the use of Compensation Committees can streamline the process of executive pay oversight.



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