



# SITTING ON A NONPROFIT BOARD



A GUIDE FOR DIRECTORS OF  
NONPROFIT ORGANIZATIONS



Hemenway  
& Barnes LLP

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Hemenway & Barnes LLP has prepared this booklet to help our clients who operate nonprofits or serve on nonprofit boards. Our goal is to summarize both the practical and legal considerations of board service in an easy to reference question and answer format. We intend it to serve as a useful reference for those considering service on a board or for those already serving as a board member. Nonprofit managers and senior staff may find it useful as well. The information contained in this booklet is not meant to serve as a substitute for independent legal counsel. Readers should consult qualified counsel with questions regarding particular legal matters.

For more information on Hemenway & Barnes LLP and our nonprofit practice, please consult our web site at [www.hembar.com](http://www.hembar.com) or contact any of our attorneys at 617-227-7940.

## **About Hemenway & Barnes LLP**

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# Introduction

A board of directors is a body of elected or appointed individuals who collectively are responsible for the activities of a company or organization. Sometimes referred to as a board of trustees, each member of the board owes fiduciary duties to the organization and each other. We will use the terms "directors" and "trustees" interchangeably.

## Board Governance: The Nuts and Bolts

### Board Governance: What Does It Mean?

To successfully serve a nonprofit organization, it is critical for directors to understand the purpose of a board of directors: governance of the organization. Governance means fulfilling the mission of the nonprofit by focusing on its strategic objectives, ensuring its financial stability and implementing a sound strategy for the organization's future. It is not the job of the board to become bogged down in administrative tasks. Because it is often difficult to draw the line between board and staff functions, it is critical for board members to grasp the concept of board governance.

***It is critical for directors to understand the purpose of a board of directors: governance of the organization***

In practice, governance means that board members are responsible for:

- Strategic planning and oversight
- Selection and evaluation of the organization's chief executive officer
- Fundraising
- Serving as ambassadors and resources for the organization

The articles of organization and bylaws should be drafted with these notions of board governance in mind and revisited periodically to ensure that the board is engaging in the best possible practices to achieve the organization's mission.

## Board Composition: Who Should Serve on a Board?

A board of directors should consist of individuals representative of diverse constituencies, each of whom is committed to the mission of the organization. Ideally, a board will comprise individuals with a variety of skill sets from a number of different backgrounds, providing the organization with a wealth of resources and perspectives. The board should review the organization's goals and requirements and ensure that the board has the membership that it needs. A board works best when it includes members with new perspectives as well as those with experience. Regular rotation of members refreshes a board. Term limits, while not required, may be appropriate.

While a diverse set of skills, experience and contacts is valuable to any board, equally if not more important is the ability to work together to further the organization's mission. Perhaps the most critical skill an individual can bring to a board is the ability to function well as part of a team.

## Board Leadership: What are the Qualities of an Effective Board Leader?

A board leader or chairperson should have a history with the organization and a full understanding of its mission prior to assuming a leadership role. Other qualities that will strengthen leadership:

- Good relationships with the organization's leadership and other board members
- Demonstrated commitment to the organization's mission
- Excellent communication and team building skills
- Resources the organization needs
- A leadership style that fits with what the organization needs
- Time, energy and common sense

Being the right leader at the right time is critical.

## Advisory Boards: What Are They?

Advisory Boards are often used by nonprofits to provide, on a short or long-term basis, additional expertise and assistance for the organization. They may act to heighten the visibility of the organization. Often they include high profile individuals who cannot assume the duties of active board members but desire to lend their contacts, connections and goodwill to the cause. If an organization chooses to appoint an Advisory Board, it is critical that its members have a clearly defined role, however limited it may be.

## Board Committees: What Are the Best Practices?

Larger boards should use committee structures to accomplish many of their goals and objectives. The committee size should be manageable - large enough to accomplish a given task and small enough to be able to make decisions quickly and efficiently. Both standing and ad hoc or special committees should be used depending on the nature and tasks of the committee. The bylaws may provide for a few standing committees that reflect key board functions critical to the board's governance role, such as an executive, finance, audit, fundraising, board development,

***It is often critical to have a well-functioning executive committee that may take actions in between board meetings and that can serve as a valuable sounding board for the chief executive officer***

governance/nominating, and program committees. In particular, it is often critical to have a well-functioning executive committee that may take actions in between board meetings and that can serve as a valuable sounding board for the chief executive officer. Special or ad hoc committees may be formed for a limited time period and for a limited purpose, such as an annual meeting or gala committee, a facility or project planning committee, a capital campaign planning committee and an executive director evaluation committee. Committees are also excellent recruitment

tools for new board members. Non-board members may serve on board committees. Committee membership (on committees other than executive, audit and nominating) is an excellent way for non-board members to become familiar with an organization, its staff and its board. However, a smaller organization that is just getting started may want to limit the number of committees until its board grows in size.

## What Standing Committees Best Serve a Board?

Executive Committee	The Executive Committee may meet between meetings of the board and serves as a smaller version of the board. An Executive Committee acts on the specific matters delegated to it by the full board and for the board in the event of circumstances requiring action before the next board meeting may be called. However, it is important that the Executive Committee not become the key decision-making body, leaving the full board only an auxiliary role.
Nominating or Board Development Committee	The Nominating, Governance or Board Development Committee should actively seek, propose and cultivate potential new board members being mindful of the "gaps" in skill sets or constituencies that exist on the board. This committee often serves as a "governance" committee with ongoing responsibility for matters relating to good governance, succession planning and strategic planning. This committee should not have as members individuals who are not currently board members.
Financial and Audit Committees	The Finance Committee is responsible for the fiscal health of the organization; the Audit Committee should work closely with key management personnel and the outside auditor to ensure that proper financial controls and practices are in place and utilized. Increasingly, the finance and audit functions are separate, with two committees fulfilling these roles. The two committees ideally have separate members as the Audit Committee provides oversight for the Finance Committee. The Chairs of the Audit

	and the Finance Committees should have a financial background or experience in financial matters.
Investment Committee	If the organization has an endowment or long-term investment account, an Investment Committee may be warranted; otherwise, investment issues are handled by the Finance Committee. The responsibility of the Investment Committee is to ensure there is a secure framework for the investment of the organization's funds. Duties of the Investment Committee include drafting investment and endowment spending policies, and hiring and overseeing the performance of the investment manager.
Fundraising / Advancement Committee	Fundraising is a key responsibility of the entire board, not just those on the Committee. Working closely with staff, the Fundraising Committee should focus on annual giving, capital campaigns, creation of an endowment and special events. Ad hoc committees may be used to supplement the Fundraising Committee for special events.
Program Committee	Board members should have familiarity with all aspects of the organization's programs and operations.  Members of the Program Committee provide more in depth oversight on operations. Their role is to be informed, observe and advise, but not to interfere with day to day operations or management functions.



## Committee Assignments

For larger boards that will have standing committees, the bylaws should contain a mechanism for assigning members and chairs to committees and designating their terms.

## Committee Assignments (continued)

The process for assigning board members and others to committees should be centralized. When selecting committee members or choosing to serve on a committee, the following factors are important to keep in mind:

- needs of the committee
- the interest, experience and preference of the board member
- committee chemistry
- relationships with staff members
- extra care should be taken when inviting non-board members to join committees

## Board Orientation: What Is It and Why Should Boards Have It?

Successful boards have board orientation programs in place to introduce new members to the organization and assist them in easing into their roles as board members. Boards should supply their members with a director's manual containing documents such as a copy of the organization's bylaws, articles of organization, latest financial statements, tax returns (Form 990s), strategic plan, publications and press releases.

A seasoned board member should be assigned to mentor each new member to ensure that the new member is connected to the board, familiar with the organization's practices and policies, and is making a valuable contribution to the board. Mentors should maintain regular contact with new board members throughout their first year on the board.

# Legal and Practical Concerns

Best practice and nonprofit law impose two primary duties upon members of the board of nonprofits: a duty of care and a duty of loyalty.

## What Does the Duty of Care Require?

By law, the duty of care requires that a director act in good faith and in a manner the director reasonably believes to be in the best interests of the organization, and with such care as an ordinarily prudent person in a like position with respect to a similar organization would use under similar circumstances.

## A Translation of the Law: What Constitutes Due Care?

- "In good faith" – the board member must exercise judgment honestly and diligently.
- "Reasonably believes" – a board member's actions should be based on objective information and consideration of all facts available.
- "Best interests of the organization" – the board member's primary duty is to the organization and to carry out the nonprofit's mission.
- "Care" – the board member must participate actively in the governance of the entity.
- "Ordinarily prudent person" – board members must act with common sense and informed judgment, but are not guarantors of the success of the organization. The "person" is not required to be a specialist, but rather one with the skills appropriate to the given task.
- "In a like position" – this phrase recognizes that the board member's duties will vary depending on his or her role within the organization, and examples of best practices observed by others in similar roles.
- "Under similar circumstances" – the board member's obligations will vary depending on the type of organization and the factual situation presented.

## Duty of Care Allows Reliance on Others:

Directors may rely on information, opinions and reports prepared by officers and employees, outside professionals and board committees, provided there is a reasonable belief that the provider is competent and authorized to provide such information, and there are not countervailing factors as to why such reliance is not warranted.

## What Does the Duty of Loyalty Require?

The duty of loyalty requires directors to act with the strictest good faith in governing the organization, mindful that they are the stewards of the mission and the funds of the organization. Directors are prohibited from unfairly profiting, directly or indirectly, from the organization.

**What Is Conflict of Interest?** When a director, director's family member, or business related to the director considers entering into a transaction with the director's nonprofit organization, a potential conflict of interest arises

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between the director's own interests and the duty of loyalty to the organization. If a board member or such member's family or business has a personal, material interest in a transaction, the board member should fully disclose this interest to the board immediately. The board member should allow the transaction to be fully discussed and vetted without his or her presence, and should not participate in any vote concerning the transaction. The board should not enter into such a transaction unless it determines that it is clearly in the best interest of the organization. The

bylaws or other governing documents should contain provisions as to how conflicts are dealt with and resolved.

**What Is the Duty of Fairness?** If a proposed transaction by the organization involves a possible conflict of interest with a director, the remaining directors must determine that the proposed transaction is at least as favorable to the organization as available alternatives.

**What About an Advantageous Opportunity?** When an advantageous opportunity comes to the attention of a director by reason of the director's position with the organization, the director must fully disclose the opportunity to the organization. The director may pursue the opportunity only if the remaining directors, after informed evaluation, determine that the organization should not pursue the opportunity.

**What about Confidentiality?** A board member should retain in confidence all nonpublic information the director receives in connection with his or her service. Confidential matters discussed at board meetings are just that – confidential. Information should not be disclosed other than to those with a legitimate need to know. Generally, individuals such as former directors, volunteers, donors, relatives, etc., do not have a legitimate need to know the organization's affairs.

## How Can a Board Member Satisfy These Duties?

In order to meet the duties of due care and loyalty, the member should consider the following:

***A director has the right to obtain the information the director needs to carry out the director's duties as a board member***

**Education:** A director has the right to obtain the information the director needs to carry out the director's duties as a board member. A director should be familiar with the articles of organization and bylaws and any board materials. A director has the right to reasonable access to internal information, to the books and records of the corporation, to management, and to the organization's outside advisors. Such requests should be made to and through the chief executive officer.

**Active Involvement:** A director should attend board and committee meetings, carefully review all material in advance of the meetings, prepare to ask questions and use independent judgment.

**Executive Director/CEO:** The directors should actively participate in selecting and regularly evaluating the executive director and in setting the executive director's compensation. By law, the executive director's/CEO's compensation must be approved by the full board. It should be consistent with the organization's financial ability and purpose and take into account market comparables.

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**Board Interaction With Staff:** Unless otherwise expressly approved by the board, communication between the board and staff of the organization should occur through the executive director/CEO.

**Conflicts of Interest:** The director should ensure that the board has a written policy for dealing with conflicts of interest and that it is followed.

**Fiscal Issues:** The board is responsible for the fiscal health of the organization, including adherence to the operating budget. The board also is responsible for risk management, and taking care that appropriate protections, including insurance, are in place. Other areas of focus include sustainability of revenue sources, spending trends, capital needs and contingency planning, among others. The board must also be aware of other financial issues such as compliance with restrictions on gifts, gift acceptance policies and bond or loan covenants.

**Compliance with the Law:** The board must ensure compliance with all applicable laws and regulations. The board should have appropriate and regular access to legal counsel, whether inside or outside of the organization

# Finance and Accounting Issues

The responsibilities of directors for financial and accounting matters are subject to oversight and scrutiny by regulating bodies, the media and the public. It is imperative that nonprofits have appropriate financial controls and procedures.

## What Financial Procedures Should a Board Implement?

**Finance and Audit Committees:** Each board of directors should have a combined or separate Finance and Audit Committee to assist the board in connection with its financial oversight. The Finance Committee at a minimum is involved in setting annual budgets and reviewing ongoing financial matters. The Audit Committee must review the organization's financial reports and other financial information, the organization's system of internal controls and ethics and the organization's auditing, accounting and financial reporting processes. As a corollary to this function, the Audit Committee must review the organization's adherence to these processes and look to continue to find ways to improve them.

*Each board of directors should have a combined or separate Finance and Audit Committee.*

**Financial Statements:** Notwithstanding the responsibilities of the Finance and Audit Committees, each board member must possess a basic understanding of the financial reports and statements of the organization.

Each board member should know the following:

- What are the major sources of revenue of the organization and how stable are they?
- What are the major areas of expense of the organization?  
How are those expenses monitored and controlled?
- How much debt does the organization have and can it afford it?
- Can the organization afford the cost of current and future programs?

**The Budget Process:** The budget process is one of the most critical aspects of nonprofit financial management. Working with the Finance Committee, management is charged with providing a budget to the board for review.

## In reviewing a budget, the board should consider the following:

- What has been the quality and accuracy of the budgeting process in the past?
- Have the current year's projections been reconciled with the last year's actual figures?
- What assumptions underlie the budget and how do they compare to those for the period year?
- What as the methodology used to project revenues and costs?
- What comparative industry information was used for performance measurements?
- What new initiatives are being undertaken in the coming year, and what is their impact upon the budget?
- What will be the back-up plan if revenue targets are not achieved, and can the organization adapt swiftly in the event that revenue projections are not met?
- What costs are variable and what costs are fixed?
- If cost reduction measures are being contemplated, how and when will they be implemented and evaluated?
- What is the capital expenditure budget and how has it been determined?
- Are appropriate reserves being built up to handle capital expenditures in the future?
- Does management have an effective procedure for monitoring actual versus budgeted results during the course of the year on at least a monthly basis?
- Is debt financing being contemplated under the budget and do the projected revenue numbers indicate that it will be able to be carried by the organization?
- Thought and consideration should be given to both annual operating budgets and capital budgets for long term needs.

If the organization has an outside auditor, a subset of the duties of the Audit Committee is to review the foregoing with the auditors independently of management in connection with their review of the financial statements and projections for the organization.

# Fundraising: What Are the Expectations?

Fundraising is one of the most important tasks for board members of nonprofits. The Board Nominating Committee should make clear to prospective members the expectations around fundraising. In the context of fundraising, board members wear two hats: the solicitor and the solicited.

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## Board Member as Solicitor: What Are the Expectations?

Board members are expected to solicit contributions. Advancement staff should be ready and able to support board members in their fundraising efforts. Board members should solicit contributions in their individual capacities and, where appropriate, as corporate representatives. Opportunities for potential corporate matching gifts or other in-kind services from corporate sponsors should not be overlooked. Diversity on the board brings strength to solicitations, since the more diverse the board, the broader and more comprehensive the fundraising reach.

All board members are capable of fundraising at some level. The key to their success is support and training. The executive director/CEO and advancement staff must have a clear plan for supporting board members in their role as fundraisers. The advancement staff should be ready and available to assist with all aspects of solicitation and gift documentation. Gift acceptance policies and the proper written documentation of gifts and gift intentions are essential.

*All board members are capable of fundraising at some level. The key to their success is support and training.*

## Board Member as the Solicited: What Are the Expectations for Board Member Giving?

Board members are expected to give money and not just time to the organization they serve. While this is a fundamental aspect of board memberships, even board members need an "ask" from the fundraising committee or other members. No one expects a board member to give



beyond his or her means, but they should make the organization they serve a philanthropic priority.

## Outside Funders: Why Do They Care About the Board? Do Boards Matter to Them?

Donors to the organization are important partners, both for the financial resources they offer and for their evaluation of the strengths and weaknesses of an organization. Donors, whether corporations, foundations, or individuals, may look closely at the composition and activity of a nonprofit board when evaluating the overall organization.

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### Why Do Funders Look Closely at the Board?

A nonprofit board has the ultimate governance and financial responsibility for the organization. Funders want to be satisfied that the board plays a major role in crafting and steering the organization's vision and philosophy and in spearheading major initiatives. Board members should be certain about the organization's mission and goals and be able to articulate them clearly to funders and others interested in the organization. Funders also focus on the board's responsibility for hiring and firing the executive director.

### What Will a Funder Examine About the Board?

Outside funders will examine the board's composition to see if it can provide strong oversight and support to advance the organization's mission. Funders will examine a board's skill set and how those skills are deployed

***Funders will examine a board's skill set and how those skills are deployed through the board's committee***

through the board's committee structure. Potential donors will want to know whether every board member makes a financial contribution to the organization. Funders may also want to evaluate board engagement with the executive director/CEO and schedule a site visit to observe the relationship with the organization's leadership.

## What Are the "Red Flags" to Outside Funders?

While boards take many shapes and sizes, there are a number of areas that might raise concern for outside funders. Lapses in board leadership and board turnover are evident to outside funders. A very small board or a very large board relative to the size of the organization or its constituency might raise concern, as would a board made up exclusively of staff. A board disconnected from the organization's mission, geography or constituency would also raise questions.

## How Can Outside Funders Help a Board?

In many instances, outside funders can help a board in ways beyond financial contributions. Funders can provide "big picture" observations on challenges and opportunities facing a particular organization, based on experience working with many different organizations, and may provide support for technical assistance or consultants to help with board development or strategic planning. Funders may also offer challenge grants to stimulate board donations and other fundraising.

***Funders can provide "big picture" observations on challenges and opportunities facing a particular organization***

# Risk Management

We live in a litigious society and nonprofits are not immune. While the rewards of service to a nonprofit are great, they are not without their risks. Board members should educate themselves to understand the risks of board service and take steps to protect themselves.

## What Are the Possible Claims?

The following are some of the types of claims that may be asserted against nonprofit organizations and their board members and officers if the circumstances warrant them:

Breach of Fiduciary Duty	As discussed in previous sections, board members have a fiduciary duty of care and loyalty to the organization. Breaches of these duties can result in liability to the organization, its governance, and in some circumstances, its directors or trustees. Failure to adopt and follow appropriate policies can give rise to such claims.
Bodily Injury and Property Damage	Accidents occur in nonprofits, as in any human activity, and may generate claims for personal injury or property damage.
Tort Claims	Negligence claims arise from an alleged breach of the duty of care by the organization or an individual in conducting its activities. Malpractice claims can arise if the organization provides professional services. Defamation claims and claims of invasion of privacy are often brought against directors and officers following statements made to the public or to

	those affiliated with the organization with no legitimate need to know of the particular incident or matter.
Employment Claims	These claims can include breach of contract claims, various tort claims, wage and hour claims, and claims under state and federal discrimination laws.
Sexual Harassment	The Board should insist that the organization have updated policies and training programs in place that minimize the risk of these claims.
Financial Matters	Mishandling and misappropriation of organization funds by officers, directors or others can give rise to breach of fiduciary duty claims.

## What are the Protections Provided by Law?

Each state has its own laws regarding nonprofit organizations. Massachusetts provides more protection to nonprofit organizations than most.

### Charitable Immunity for the Organization:

Massachusetts General Laws Chapter 231, §85K (the Massachusetts charitable immunity statute), provides certain charitable immunity for public charities. The statute applies only to tort claims, and not to other types of claims such as breach of contract. The statute limits the organization's liability to \$20,000, exclusive of interest and costs, if the tort occurred in the course of any activity "carried on to accomplish directly the charitable purposes of the organization. To the extent the tort was committed while

the organization was pursuing "activities primarily commercial in character," the cap does not apply.

### Protection for Officers, Directors and Trustees:

Massachusetts General Laws Chapter 231, §85W, applies to officers, directors or trustees of nonprofit charitable corporations, including, but not limited to, nonprofit corporations qualifying under I.R.C. §501(c)(3), and provides that they shall not be held liable for civil damages resulting from acts or omissions "relating solely to the performance of his duties as an officer, director or trustee...." Excluded from protection are grossly negligent or intentionally harmful acts or omissions. The protection is available only if the individual serves without compensation. Reimbursement of expenses is not compensation. No protection is available if the act was "committed in the course of activities primarily commercial in nature." In addition, the Massachusetts charitable immunity statute contains an exemption from liability for officers, directors or trustees of educational institutions qualified as tax exempt under I.R.C. §501(c)(3) if they were at the time of the act or omission acting in good faith and within the scope of their official duties and functions. Such individuals must serve without compensation to be protected and the protection does not apply to any injury or damage arising from the operation of a motor vehicle.

A third statute, Massachusetts General Laws Chapter 180, §3, provides that the articles of organization of a nonprofit corporation may include a provision eliminating or limiting the personal liability of officers or directors to the corporation or its members for breach of fiduciary duty. Liability cannot be eliminated where the director or officer breaches the duty of loyalty, or was involved in intentional misconduct or a knowing violation of the law, or where the acts were not in good faith, or where the individual received an improper personal benefit. If an organization wishes to give its directors and officers this extra protection, it must include it in its Articles of Organization.

**The Volunteer Protection Act of 1997:** In addition to state law, federal law provides a layer of protection to board members. Passed by Congress

***In addition to state law, federal law provides a layer of protection to board members***

in 1997 to encourage volunteerism, the Volunteer Protection Act limits liability of volunteers of nonprofit organizations, including board members, for harm caused by an act or omission of the volunteers while acting within the scope of the volunteers' responsibilities, provided that the harm was not caused by willful or criminal misconduct, gross negligence or reckless indifference to the safety of others. Indemnification: A Massachusetts nonprofit corporation may, by statute, agree to defend and pay claims against its officers, directors, employees and agents. Indemnification may not be provided if the individual has been adjudicated as having failed to act in "good faith in the reasonable belief that his action was in the best interests of the corporation."

## How Can Insurance Provide Protection?

The corporation also may provide indemnification by contract or insurance. Any indemnification protection will be of little value if the organization does

***The organization should regularly, with legal counsel, conduct an "audit" of its insurance coverage to see if it has obtained the proper coverage.***

not have sufficient, unrestricted assets from which to fund the obligation. Insurance can bridge this gap, and board members often look to or require directors and officers ("D&O") liability coverage for their protection. All required insurance (e.g., general liability, employee claims, property or casualty) should be reviewed by the Board, because most claims will not be covered by D&O, but rather by other types of insurance. The

organization should regularly, with legal counsel, conduct an "audit" of its insurance coverage to see if it has obtained the proper coverage.

# Beyond Flattery and Food

You are now aware of many of the basic roles, responsibilities and concerns of board members. Here are some key questions to ask as you consider board service.

## What Should You Consider Before Joining a Board?

- Are you committed to the mission of the organization?
- Does the work of the organization conflict with work you are doing for another organization?
- Do you have the ability to make the organization a philanthropic priority?
- Do you have time for this commitment?
- Do you feel comfortable with the board?
- Does the organization have a capable leadership team?
- Are your expectations consistent with the organization's?
- Have you seen the most recent audited financials or tax return?
- Have you reviewed the budget?
- Having reviewed financial materials, do you understand the sources of revenue and significant liabilities?
- Are you enthusiastic about the leadership and structure of the board?

## How Long Should You Serve on a Board?

Most bylaws provide terms regarding the appointment of a board member and the length of service. While some long term board members can be invaluable to an organization, board turnover is often important to keep boards from becoming static. Some organizations provide for term limits for their board members. Even with term limits, there may be occasions when a board member determines that he/she should move off the board for personal or professional reasons or for the good of the organization. In that event, the board member can resign.

## Conclusion

Service on a board of directors has the potential to be an incredibly worthwhile endeavor for the organization, the board member and the community-at-large. The organization benefits from the board members' professional skills and financial commitment and, in fact, could not exist without them. The board member benefits from the personal satisfaction of having contributed to a charitable organization. In addition, the board member enhances professional and personal networks through board service. Finally, the community is served through the existence of well-run organizations – museums, schools and social service agencies are enriched in the process.

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Conclusion

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