

# What Every Nonprofit Board Member Should Know: 6 Essentials

By Teresa Santalucia

## Introduction

Family foundations play an essential role in mission-driven charitable giving. Known for tight local ties, a focus on distinct public policy and social issues, and long-term partnerships with nonprofit agencies,<sup>1</sup> family foundations are indispensable in meeting human needs and fostering social change.

Family foundation officials may redouble their commitment to social progress by serving on the board of a not-for-profit organization (“NPO”).<sup>2</sup> Using their foundation experience, foundation officials are well-positioned to leverage their expertise in program planning, management, and relationship-building to support the charitable NPO sector.

This article thus discusses six essentials for those serving on public charity NPO boards. It provides a road map for new directors so that they may hew closely to their organization’s charitable purpose, master the “rules of the road” in their organization’s governance documents, comply with legal duties, fulfill their managerial responsibilities without duplicating the efforts of executive staff, and meet state and federal reporting requirements. An understanding of each of these tasks is crucial for directors, recently appointed and long-serving alike.

Moreover, level setting on board responsibilities can help increase and democratize board participation and

improve board retention. The most successful NPO boards look to the future, and as a matter of course they pursue opportunities to recruit new directors, particularly those who may have been overlooked in the past like young people, people of color, and community members who are most impacted by the issues the NPO seeks to address. Board training is a diversity and inclusion tool. Empowering new directors with information to help them hit the ground running can foster an inclusive environment for directors from diverse backgrounds. As you read the article, consider who within and outside of your circle might benefit from the information and how it might best cultivate the next generation of NPO board leaders.

## #1 NPOs Are Organized and Operated to Advance a Designated Charitable Purpose.

By definition, an NPO is one that is barred from distributing its net earnings among the members, officers, and directors who control it.<sup>3</sup> While a for-profit entity is organized and operated to generate profits for its shareholders, an NPO is organized and operated to advance a charitable, educational, literary, etc. purpose. When hiring an executive director, approving programmatic decisions, and brokering new partnerships on behalf of the NPO, board members look to the purposes itemized in the NPO’s organizational documents to ensure they are charting the right course. Qualifying as an NPO under section 501(c)(3) requires adherence to a specifically designated tax-exempt

purpose such as a charitable or educational goal.<sup>4</sup>

Relatedly, NPO board members may not engage in private inurement: they are forbidden from using the NPO’s resources for their personal gain. If an NPO were to excessively benefit its “insiders”—its directors and officers—then it would no longer be organized and operated to serve its tax-exempt purpose. NPO board members may not use the entity’s money for personal expenses. If a board member transacts with the NPO by, for example, leasing property or performing a professional service, they must take care to do so via the proper channels, reaching an outcome that is fair for both parties.

Lastly, political activity is not a recognized charitable purpose under section 501(c)(3)—the IRC explicitly limits NPO’s engagement in such activity.<sup>5</sup> NPOs provide unlimited advocacy and may lobby so long as lobbying does not become a substantial part of its activities.<sup>6</sup> NPOs may *not* engage in any partisan electioneering, such as making

<sup>4</sup> 26 U.S.C. § 501(c)(3) (The operative language: *Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.*)

<sup>5</sup> 26 U.S.C. § 501(c)(3).

<sup>6</sup> *Id.*

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<sup>1</sup> See generally Charles S. Weiss, *Family Foundations: A Case Study Approach*. 28 *New Directions for Philanthropic Fundraising* 19, 19-36 (2003).

<sup>2</sup> Throughout the article I will refer to not for profit, or nonprofit, corporate entities exempt from taxation by the Internal Revenue Services (“IRS”) under Section 501(c)(3) of the Internal Revenue Code as Amendment (“section 501(c)(3)”) as NPOs. While the majority of the article applies to a variety of NPOs the focus is on “public charities”.

<sup>3</sup> *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564, 585 (1997) (finding that “A nonprofit entity is ordinarily understood to differ from a for-profit corporation principally because it “is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees.”).

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statements and donations in favor of certain candidates, though nonpartisan voter registration and political education are acceptable.<sup>7</sup>

### **#2 NPOs Are Typically Incorporated Under State Law and Governed by Two Key Documents: Articles of Incorporation and Bylaws.**

NPOs are subject to a hierarchy of authorities. First, as creatures of both state and federal law, they must comply with the state corporation statute under which they are organized, as well as

governing document is the Articles of Incorporation, or corporate charter, which serve as the NPO's "birth certificate." The Articles of Incorporation acknowledge the NPO's formation under state law, identifying its name and purpose and describing its rights and power. Committing the NPO's purpose as stated in the Articles of Incorporation should be required by all board members so they understand the legal purpose of the entity. If the NPO evolves over time such that the Articles of Incorporation are no longer relevant, new Articles of Incorporation must be filed with the state and submitted to the IRS for approval.

### ***Board members generally have three primary fiduciary duties: the duty of care, the duty of loyalty, and the duty of obedience.***

federal statutes, primarily the IRC and related guidance, that allow for their tax exemption. Second, NPOs must comply with their bylaws, the internally written and maintained "house rules" that dictate how the NPO will handle its day-to-day business. Third, NPO boards have decision making authority—state corporation statutes typically vest the management of the NPO in the board. If the NPO is a member organization—for example, a grassroots organization in which members are charged with voting on major decisions—then the members have separate authority from the board. The fourth and final tier of authority comprises those who are subject to the board's control—board committees and executive officers, which conduct planning and diligence to shape the NPO's future.

The board of directors plays a central role in any NPO from inception to dissolution. As soon as the NPO is incorporated, the board of directors is responsible for making sure that the NPO is run in accordance with specific governing documents. The first

Once the NPO has been incorporated with the filing of the articles, board members should look to adopt bylaws for directives on how to run the corporate affairs of the NPO. There is no one template for bylaws, but they should detail the following:

- the composition and duties of the board;
- the rights of and criteria for membership;
- the appointment process for board and executive officers;
- the creation and use of committees;
- the schedule and notification requirements for meetings; and
- the process for amending the bylaws and dissolving the NPO.

The bylaws are not an academic exercise intended to be drafted and forgotten. They should be a clear, concise playbook that board members utilize on a regular basis. A living document, the bylaws should be revised as needed to reflect current practice. The articles and bylaws should not conflict, but instead work together to provide guidance to the board.

### **#3 NPO Board Members Have "Fiduciary Duties," Legal Responsibilities to Make Rational, Informed Decisions and Advance the NPO's Purpose.**

NPO board members are held to high, legally enforceable standards of conduct, and their responsibilities are known as fiduciary duties. When one accepts an NPO board position, she becomes a "fiduciary" or agent of the NPO, acting on the NPO's behalf to advance only the NPO's interests. While it may vary state to state, board members generally have three primary fiduciary duties: the duty of care, the duty of loyalty, and the duty of obedience.

The duty of care requires board members to make rational, informed decisions on behalf of the NPO. Fulfilling this duty entails staying informed by reading board reports; preparing for, attending, and actively participating in committee meetings; and developing a thorough understanding of the NPO's budget, financial statements, and audits. A board member who wishes to adhere to the duty of care will monitor the NPO's performance, comply with the bylaws, participate in board discussion, and vote independently. If board members are negligent in adhering to their duty of care, mismanagement may occur.

The duty of loyalty requires NPO board members to perform their roles in good faith, acting in the best interest of the organization. Conflicts of interest, situations that put directors' personal interests at odds with their duty to advance the NPO's charitable purpose, are inevitable, even in NPO settings. Board members may own a business that contracts with the NPO or may recommend their daughter or son for an internship at the NPO. If poorly managed, both examples could constitute a conflict of interest. The duty of loyalty does not forbid board members, as fiduciaries, from having close ties to the organization. Instead, it compels them to manage these ties with integrity, following their bylaws and the internal conflict

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<sup>7</sup> *Id.*

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of interest policy. Conflict of interest policies typically direct board members to immediately disclose potential conflicts and to recuse themselves from voting on decisions in which their financial or personal interests are implicated.

The duty of obedience is less frequently cited, and is not applicable in all states, but it is important to keep in mind. It requires board members to ensure that NPOs' resources are used in a manner consistent with the NPO's purpose. The duty of obedience underscores the importance of mastering the NPO's purpose language outlined in the Articles of Incorporation to guide the organization's operations.

Board members may face legal suit if they breach their fiduciary duties. They can also be held liable for knowingly participating in wrongful acts, and even for wrongful actions of the NPO itself. There are, however, several forms of liability protection that can safeguard upstanding board members. Prospective board members should be in dialogue with NPO staff to determine whether the NPO holds directors and officers' liability insurance or indemnifies its directors in its organizational documents. State statutes, such as charitable immunity laws, also protect board members from legal liability.

#### **#4 In Addition to their Legal Responsibilities, NPO Board Members Must Undertake Various Management Tasks.**

Board members are both leaders and managers.<sup>8</sup> As leaders, they inspire change through the new relationships, plans, and initiatives they facilitate for their NPOs.<sup>9</sup> As managers, they foster order and consistency, adopting policies and helping processes that can keep NPOs financially solvent and legally

compliant.<sup>10</sup> While boards' management duties may be less alluring than their leadership duties, the most valued board members are often those who can substantively contribute to the governance of their organizations.

A key management responsibility is hiring NPO employees, such as the executive director. Once hired an executive director should then be evaluated, supported, and if necessary, terminated, by the Board. Working closely with an executive director the board may also have input on hiring other senior staff such as directors of development, finance, and operations who act as auxiliaries to the executive director. However, board members should understand the line of communication and try to work through the executive director to create a clear line of authority as discussed below.

Board members are also responsible for overseeing NPOs' finances. "Running the numbers" by scrutinizing and approving the budget, completing audits, and maintaining operating reserves is integral to board management. Board members should feel free to call on experts, such as accountants and auditors, to review the NPO financials and provide guidance in this area.

Importantly, boards' management function requires drafting and implementing internal policies. Internal policies are good governance tools—they ensure boards do not run afoul of their fiduciary duties. For instance, a conflict of interest policy will detail step-by-step how a board member manages a potential conflict. Without such a policy, boards may be required to abandon worthwhile projects, or worse, may be tempted to "self-deal," acting in their own best interest instead of that of the NPO. In addition to conflict of interest policies, boards should draft and review other corporation policies such as the following:

- Whistleblower Policy;
- Document Retention Policy;
- Written information security policy, and
- Investment Policy.

When board members act as leaders, engaging in long-term planning, fundraising, or public relations, the results are far-reaching. Among the most critical of their leadership tasks is developing new talent. Board members should always identify suitable candidates to deepen, diversify, and replenish their ranks. Recruiting board members from the NPO's geographic service area or nominating young staff for board service can bolster the board's relevance and depth of thought.

#### **#5 Establishing the Line Between the NPO Boards' and Executive Directors' Respective Responsibilities: Oversight vs Implementation.**

Tension often arises between board members and staff. Both parties steer the NPO, so "turf battles" between them are common. When boards and staff disagree over issues where their responsibilities overlap—preparing the organization's strategic plan, setting the organization's budget, crafting internal policies—it is helpful to take a step back to review each party's roles.

NPOs can mitigate board-staff conflicts by clarifying the distinction between the board's role as a governance and oversight body and staff's role as implementers. Board members are charged with hiring the executive director, adopting, and updating policies, developing the NPO's vision and strategy, approving and monitoring the NPO's budget, and engaging in advocacy and fundraising. Executive directors are charged with enacting policy and formulating procedures, carrying out the NPO's vision and strategy, hiring and managing staff, proposing the NPO's budget, and engaging in advocacy and fundraising. The board safeguards the NPO's vision, finances, and legal integrity, while the executive director and her or his team handle the NPO's daily operations.

Board members should embrace the close relationship between their duties and those of executive staff. A cooperative board-executive relationship often undergirds high-functioning NPOs.

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<sup>8</sup> Caitlin McMullin & Paloma Raggio, *Leadership and Governance in Times of Crisis: A Balancing Act for Nonprofit Boards*, 49 *Nonprofit & Voluntary Sector Quarterly* 1182, 1183-1184 (2020).

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

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Forgoing conflict for collaboration where their duties overlap, these leadership teams coordinate their efforts. Board members on such teams will introduce executives to potential donors, allowing the executive director to act as an organizational spokesperson and make the final pitch. They will also defer to the expertise of finance staff, imbibing their findings at meetings, while also asking probing questions and conducting external audits as needed. When board members balance engaging and supporting executive staff with maintaining the distance required for organizational governance, their organizations are better for it.

### **#6 Compliance Matters: Boards Must Ensure That their Organizations Complete Annual Reporting to Government Officials at the State and Federal Levels.**

Finally, board members must familiarize themselves with the bevy of state and federal reporting requirements for NPO organizations. Timely reports ensure that NPOs can maintain their tax-exempt status, continuing to benefit from tax-deductible contributions and local sales and property tax exemptions. Annual filing requirements also promote transparency and donor confidence. When prospective donors review an NPO's publicly available records, they can determine whether an organization is managed with the requisite propriety to merit their financial support.

Multiple state agencies promulgate requirements for NPOs. For instance, Massachusetts NPOs must file annual reports with the Secretary of the Commonwealth and the Attorney General's Office. NPOs report to the Secretary of the Commonwealth on corporate compliance matters. The Secretary requires a report that includes the names of their officers, their principal address, and the date of their most recent annual meeting.<sup>11</sup> NPOs report to the Attorney General's Office on their charitable assets

and solicitation practices. Each year, the Attorney General requires a comprehensive document, "Form PC," that details NPOs' programming, activities, and financials.<sup>12</sup> It summarizes NPOs' annual inflows and outflows, executive compensation, and "related party" transactions. Most states require similar filings. Board members must familiarize themselves with the pertinent agencies in their state and the agencies' attendant reporting needs.

The Internal Revenue Service also promulgates annual notice requirements for NPOs in its Form 990, a document that plays a role analogous to a wage earner's tax return. Tax-exempt organizations with sizable gross receipts must complete the form to show their revenues, expenses, and assets.<sup>13</sup> The form also requires information on NPOs' mission, activities, and governance structure. Form 990 thus provides a comprehensive picture of NPOs' fiscal and programmatic year. If the form shows that NPOs have continued to comply with the Internal Revenue Code, then they maintain their tax-exempt status. Board members can determine if their NPO is up to date in its IRS reporting requirements by accessing the IRS "Select Check" Tax-Exempt Organization Search tool.

### **Conclusion**

This article presents six essentials for NPO board members. First, NPOs are organized and operated to advance designated tax-exempt purposes—it is the board's duty to ensure that stated purposes are at the heart of the NPO's decision-making. Second, board members must familiarize themselves with the NPO's organizational documents, including its articles of incorporation, which found the NPO, and its bylaws, which govern the NPO. Third, under their fiduciary duties, board members are expected to be informed and independent. Fourth, board members are managers; they must adopt policies, manage senior staff, while also looking after the NPO's finances. Fifth, board members are expected to both collabo-

rate with the executive director and engage in unsparing monitoring. Sixth, board members should keep their organizations compliant with state and federal reporting requirements.

These six essentials are the basics of good governance. Board members with a working knowledge of their legal responsibilities and organizational roles are tremendous assets for an NPO. As new board members become acclimated to board service, the tasks described in the six essentials will become second nature. The foresight required for writing internal policies, the basic financial acumen required for reviewing balance sheets, and the diligence required to scrutinize the board book in anticipation of annual meetings are each a learnable skill. Board service need not be intimidating.

Board members who are still developing their managerial know-how can position themselves for success by leading with the passions that drew them to board service in the first place. Show up to board and committee meetings prepared to contribute. Be attentive outside of meetings and find ways to leverage your talents and network for the greater good of the NPO. Refer frequently to your organization's purposes and bylaws and use them to find common ground among board members, executives, and other stakeholders. Finally remember the purpose of the NPO you support, and why it has meaning to you, and your NPO will benefit from your board service.

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<sup>12</sup> M.G.L. ch. 12 § 8F

<sup>13</sup> 26 U.S.C. § 6104(d)

<sup>11</sup> M.G.L. ch. 180 § 26A



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