A GUIDE TO NONPROFIT BOARD SERVICE

Dear Board Member:

Thank you for serving as a director of a nonprofit charitable corporation. Oregonians rely heavily on charitable corporations to provide many public benefits, and our quality of life is dependent upon the many volunteer directors who are willing to give of their time and talents.

Although charitable corporations vary a great deal in size, structure and mission, there are a number of principles which apply to all such organizations. This guide is provided by the Attorney General’s office to assist board members in performing these important functions. It is only a guide and is not meant to suggest the exact manner that board members must act in all situations. Specific legal questions should be directed to your attorney. Nevertheless, we believe that this guide will help you understand the three “R’s” associated with your board participation: your role, your rights, and your responsibilities.

Active participation in charitable causes is critical to improving the quality of life for all Oregonians. On behalf of the public, I appreciate your dedicated service.

Sincerely,

Ellen F. Rosenblum
Attorney General
Board members are recruited for a variety of reasons. Some individuals are talented fundraisers and are sought by charities for that reason. Others bring credibility and prestige to an organization.

But whatever the other reasons for service, the principal role of the board member is stewardship. The directors of the corporation are ultimately responsible for the management of the affairs of the charity. This requires active participation. People who do not have the time to regularly participate should not agree to be on a board. The board must insure that the organization is operated for a charitable/public purpose; it may not be operated for private benefit. Proper stewardship requires that the organization’s assets be held “in trust,” to be applied to its charitable mission.

One of the most important functions of the board is keeping the resources and efforts focused on the charity’s mission. This requires the board to have an adequate understanding of the organization’s programs, people and resources available to achieve the organization’s goals. As a starting point, every board member should be familiar with the organization’s Articles of Incorporation and Bylaws.
Board members' roles may vary greatly depending upon the size and nature of the organization. Some small organizations do not have paid staff, in which case board members may be actively involved in all aspects of the organization's operation. In larger organizations, the board is typically not expected to manage the day-to-day activities of the charity. The directors appoint officers so that they, in turn, can carry out the day-to-day activities of the organization. It is the board's responsibility to hire the chief executive officer (often referred to as the executive director) and to oversee that person's work in fulfilling the organization's mission.

A related function of the board is to set the compensation of the charity’s CEO. Every board member should know what the CEO is paid and participate in the final decision. The compensation should be reasonable for the services rendered and be comparable to similarly situated executives. The board should remember that CEO compensation, as well as that of other key executive officers, may be important to donors, beneficiaries and the community-at-large. The compensation levels will be reported in financial reports which will be accessible to the general public.
UNDERSTANDING YOUR RIGHTS

In order to carry out your legal responsibilities as a board member, you must be able to make informed judgments about important matters regarding the organization and operations of the charity. The law permits you to reasonably rely on information from the charity’s staff, its lawyer, its accountant, outside advisors, and board committees in making those judgments.

Your right to information includes the following: you have the right to reasonable access to management, to have reasonable access to internal information of the organization and to the organization’s principal advisors, such as its auditors and lawyers. Senior management must also be willing to facilitate board access to books and records of the charity. The board has the right, if necessary, to engage the services of outside advisors at the charity’s expense to assist it with a particular matter.
In carrying out board responsibilities, the law generally imposes three duties of trust. They are regularly described as the duties of due care, loyalty to the corporation and obedience to the law.

**Duty of due care.** This responsibility generally requires that a director must discharge the duties with the care an ordinary prudent person in a like position would exercise under similar circumstances. ORS 65.357. Directors need not always be right, but they must act with common sense and informed judgment. To exercise this duty properly, boards must pay particular attention to the following:

- **Active participation.** A director must actively participate in the management of the organization including attending periodic meetings of the board, evaluating reports, reading minutes and reviewing the performance of the executive director.

- **Reasonable inquiry.** Directors should request and receive sufficient information so that they may carry out their responsibilities as directors. When a problem exists or a report on its face does not make sense, a director has a duty to inquire into the surrounding facts and circumstances. The director also has a duty to investigate warnings or reports of officer or employee theft or mismanagement.
Duty of loyalty. Directors have a duty to give their undivided loyalty to the charitable corporation. Decisions regarding the organization’s funds and activities must promote the organization’s public purpose rather than private interest. Any potential conflict transactions should be scrutinized closely by the board with the realization that the public will predictably be skeptical of such arrangements. There are some general principles which will serve to guide boards faced with conflict of interest situations.

- Conflicts in general. While transactions between the charitable corporation and individual board members, their families and businesses they own or operate should be avoided, they are not absolutely prohibited. Under certain circumstances, a contract or transaction between a nonprofit corporation and its director or an organization in which the director has a material or financial interest is acceptable. However, if the transaction is challenged, the director will have the burden of establishing that the contract or transaction is fair and reasonable, that there was full disclosure of the conflict and that the contract or transaction was approved by members or other directors in good faith. ORS 65.361. The board should only approve the transaction if it is clearly in the best interest of the charity.
• **Written policy.** The board should establish a written policy for dealing with conflicts of interest. The policy should address disclosure of financial interest and withdrawal from discussion and voting by interested directors. Due to the sensitivity of conflicts of interest, the board may want to require that transactions benefiting a director may be approved only by a greater than majority vote. Also, requiring an annual disclosure by all board members of their business involvement with the nonprofit organization is recommended.

• **Loans.** In general, a charitable corporation may not lend money to an officer or director. There is one statutory exception. The law allows loans for executive relocation expenses under certain circumstances. ORS 65.364.

• **Corporate opportunity.** Directors of business organizations are under a fiduciary obligation not to divert a corporate business opportunity for their personal gain. A director of a nonprofit corporation is also subject to this duty. This duty means that a director may not engage or benefit from a business opportunity that is available to and suitable for the corporation unless the corporation decides not to engage in the business opportunity and conflicts of interest procedures are followed.
Duty of obedience. Directors have a duty to follow the organization’s governing documents (Articles of Incorporation and Bylaws), to carry out the organization’s mission and to ensure that funds are used for lawful purposes. Also, directors must comply with other state and federal laws that relate to the organization and the way in which it conducts its business. For example, directors should be familiar with:

- **Federal law.** Charitable corporations usually apply to the Internal Revenue Service for exemption as a tax-exempt organization. Corporations which fail to do so may have their income taxed at normal rates, and contributors to the corporate charity may not be able to deduct their contributions on their income tax returns.

- **State law.** In general, charities must register and file an annual financial report with the Attorney General’s office. If an organization contemplates using bingo or raffles to raise revenue, it may need to obtain a charitable gaming license from that same office. A nonprofit corporation must also file an annual renewal with the Corporation Division of the Secretary of State’s office.
• **Mission and procedures.** Directors should be familiar with the organization’s governing documents and should follow the provisions of those documents. Directors should be sure proper notice is given for meetings, that regular meetings are held, that directors are properly appointed and that the organization’s mission is being accomplished.

**Other duties.** In addition to the above three general fiduciary duties, there are a number of specific responsibilities which must be observed by nonprofit corporate board members.

**Satisfactory corporate documents and records.** A charitable corporation is required to have Articles of Incorporation and Bylaws. You should see that they are updated and consider amendments if they do not reflect the current mission and operating procedures of the organization. The organization is also required to keep minutes of its board meetings and a record of all actions taken by committees of the board of directors. ORS 65.771.
**Adequate financial records and controls.** One of the board’s responsibilities is to oversee the organization’s financial affairs, making sure that the organization has adequate internal accounting systems and controls. With embezzlement from nonprofit organizations on the rise, it is imperative that financial controls are in place before theft occurs. The board should be responsible for approving the organization’s annual budget. Board members should expect the CEO (or other designated staff) to produce timely and adequate income and expense statements, balance sheets and budget status reports, and should expect to receive these in advance of board meetings. With the advent of online banking, many small organizations neglect to retain copies of their bank statements. Board directors should ensure that appropriate accounting and banking records are being maintained. With large organizations, the board should employ, either directly or through an audit and finance committee, an independent auditor and review the auditor's annual report at a face-to-face meeting.

**Safeguarding.** The board should oversee the effective use of the resources of the organization. Policies should be adopted and large transactions approved to ensure that the organization’s assets are not misapplied or wasted. The board should ensure that the assets are invested prudently, avoiding high risk investments and employing some diversification of investments.
Observing donor restrictions. All donations must be used in a manner which is consistent with the organization’s stated mission. However, some donors designate that gifts are to be used for a particular purpose. It is important to keep faith with donor intentions. The board is obligated to see that such restricted funds are used for the stated purpose(s).

Responsible solicitation activities. Some organizations decide to hire professional fundraisers to conduct or assist in soliciting donations. When hiring a fundraiser, select one who is trustworthy; ask for references. Make sure any contract with a professional fundraiser or consultant, especially the terms for compensation, is fair and reasonable from the charity’s perspective. Be aware that most donors expect the majority of their contributions to be used for program services and that many “watchdog” organization standards limit annual fundraising costs to no more than 35% of total expenditures. Certain types of contracts require the organization’s officers and directors to observe specific procedures. ORS 128.814.
PERSONAL LIABILITY

It is possible that board members of a charitable corporation will find themselves sued as personal defendants in a lawsuit filed by an “outside third party” who has incurred some personal injury or financial loss as a result of dealings with the organization. To encourage citizens to serve as board members for charities, the law cloaks volunteer board members with qualified immunity. They cannot be sued for negligent acts. They may, however, be subject to lawsuits alleging that a loss was due to their gross negligence, willful or fraudulent acts.

NOTE – The IRS may also hold directors personally liable if the organization violates federal tax law. The most likely situation is the failure of the organization to perform mandatory payroll withholding.

Because there is some degree of risk, including the cost of defending a frivolous claim, directors should discuss with the organization’s attorney the prospect of purchasing directors and officers (D and O) liability insurance, and/or including indemnification provisions in the organization’s governing documents.
STATEMENT OF NONDISCRIMINATION AND COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT (ADA)

The Americans with Disabilities Act of 1990 (ADA) requires all programs, services and activities of state and local governmental agencies to be accessible to persons with disabilities.

The Oregon Department of Justice does not discriminate in providing access to its programs, services and activities on the basis of race, color, religion, ancestry, national origin, political affiliation, sex, age, marital status, sexual orientation, physical or mental disability, or any other inappropriate reason prohibited by law or policy of the state or federal government.

For additional information regarding (1) the department’s ADA compliance, (2) its policy of nondiscrimination, (3) availability of the information in this pamphlet in a different format or (4) procedures for resolving a complaint that the department has discriminated in providing access to the department’s programs, services and activities - please contact the department’s ADA coordinator:

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