



## 508 10 Things to Know If You Represent a Nonprofit

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## Faculty Biographies

### Mallory B. Duncan

Mallory B. Duncan is senior vice president, general counsel of National Retail Foundation in Washington, DC. He is responsible for coordinating strategic legislative and regulatory initiatives involving customer data privacy, bankruptcy, fair credit reporting, and truth-in-lending.

Prior to joining NRF, Mr. Duncan served as corporate counsel in the Washington office of the JC Penney Company Inc., where he advised stores and headquarters on federal and state legislative and regulatory issues. He was an attorney advisor in the Office of Policy Planning at the Federal Trade Commission and was previously associated with the law firm of Sutherland, Asbill & Brennan.

Mr. Duncan has served on the boards of several nonprofit organizations throughout his legal career, including the National Hospice Foundation. His publications include the Federal Trade Commission's *Policy Guidance on Civil Penalties* and coauthorship of "Fair Credit Reporting Act Creates New Duties for Employers," *Credit World*.

Mr. Duncan is a graduate of Pomona College and Yale Law School.

### Shelley Z. Green

Shelley Z. Green is senior director and general counsel of The Shefa Fund, a nonprofit organization with offices in Philadelphia and Los Angeles. In this dual role, she counsels the organization on governance, strategic planning and program design, in addition to handling legal matters in areas including exempt-organizations, fundraising, securities regulation, and intellectual property.

Ms. Green joined Shefa after over 15 years as general counsel of the University of Pennsylvania, where she supervised a team of attorneys and advised board and senior management on all legal issues, including compliance, civil rights, technology transfer, and human resources. She began her legal career as a litigator with the Washington DC firm of Sutherland, Asbill and Brennan and worked in the US Department of Health, Education and Welfare.

She chairs ACCA's Nonprofit and Professional Associations Committee and has served on the board of ACCA's Delaware Valley Chapter. She is a member of the board of the Jewish Community Relations Council of Greater Philadelphia.

Ms. Green received an AB from Vassar College and her JD from Harvard Law School.

### Ellen J. Vargyas

Ellen Vargyas is general counsel of the American Legacy Foundation in Washington, DC. She is responsible for providing advice and counsel on a wide range of issues including intellectual property, corporate governance, advertising, employment, and contract negotiations. She is also responsible for managing Legacy's litigation. Legacy is a national, independent public health

foundation dedicated to reducing youth tobacco use, decreasing exposure to second hand smoke, increasing successful quit rates, and expanding access to prevention and cessation services.

Ms. Vargyas has long pursued a career dedicated to the practice of law in the public interest. Prior to joining Legacy, she served as legal counsel to the U.S. Equal Employment Opportunity Commission during the Clinton administration, where she directed the commission's regulatory and policy program and served as in-house counsel. Ms. Vargyas was senior counsel for employment and education at the National Women's Law Center in Washington, DC, where she handled precedent-setting Title IX litigation in the areas of harassment and gender-equity in athletics, was actively involved in the passage of major legislation that redefined and expanded legal protections against discrimination in employment, and published on legal issues of concern to women. She also directed the Access to Justice Project at the National Legal Aid and Defender Association in Washington. Ms. Vargyas began her career as an attorney with Community Legal Services in Philadelphia, where she provided legal representation to low-income clients.

Ms. Vargyas is a graduate of Williams College and the University of Pennsylvania Law School.

### **J. Mark Waxman**

J. Mark Waxman is the general counsel for CareGroup, Inc., a nonprofit healthcare system which includes the Beth Israel Deaconess Medical Center academic health center, five community hospitals, and multiple physician organizations.

Prior to CareGroup, Mr. Waxman was a partner in the Los Angeles and Washington, DC offices of Foley & Lardner and a member of the firm's health law and litigation departments. He chaired the firm's mid-Atlantic and eastern United States health law practice. He served for over six years as the general counsel to the California Association of Health Facilities. Mr. Waxman served as counsel before the United States Supreme Court in *Summit Health, Ltd. V. Pinhas*, 111 S.Ct. 1842 (1991). Before joining the firm, Mr. Waxman was an Assistant United States Attorney for the Central District of California.

Mr. Waxman has served as a hearing examiner for the Los Angeles Police Commission and on the boards of directors of the Thaliens Community Mental Health Clinic, Alternative Living for the Aging, the Venice Family Clinic, and Bet Tzedek Legal Services. He is vice chairman of the ABA's Health Law Section Medical Research, Technology and Ethics Subcommittee. He was a member of the American Hospital Association's Task Force on Antitrust and Business Coalitions and of the Board of Directors of the American Health Lawyers Association. He is a member of the BNA Health Law Reporter Advisory Board, the American Health Lawyers Association, the Healthcare Financial Management Association, and the American Subacute Care Association.

Mr. Waxman is a summa cum laude graduate of the University of California, San Diego and the Boalt Hall School of Law, University of California, Berkeley, where he was articles and book review editor of the *Ecology Law Quarterly*.

**CORPORATE COUNSEL  
AND THE NONPROFIT ORGANIZATION**

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## **Corporate Counsel And The Nonprofit Organization**

### **I. What is the role of the General Counsel in a nonprofit organization such as an association or foundation?**

- The General Counsel (GC) is the Chief Legal Officer of the organization. In general, the GC is responsible for providing legal advice to the Board, the President, and Senior Management. The client, however, is the organization itself, and not any one or a group of individuals. It is important to recognize this distinction and avoid accidentally creating other, potentially, conflicting attorney-client relationships. (See e.g. Friedman, "The Creation of The Attorney-Client Relationship: An Emerging View", 22 Cal. W.L. Rev. 209 (1986); South Carolina Ethics Op. 94-27).
- Among the challenges a General Counsel faces is the need to keep current on the law, particularly as it relates to nonprofit organizations, and to avoid conflicts of interest.
- Beyond the principal legal function, nature of nonprofits is such that the General Counsel is likely to be called on to wear more hats than if he or she were in a for-profit organization. Stretched resources mean that the GC will likely spend as much or more time working on the "mission" of the organization, or general business matters, than on legal matters. This does not mean the GC should ever not "act like a lawyer" with respect to documenting legal advice and explaining the implications of the applicable law and regulations to the client organization.
- In Washington, D.C., for example, many GC's either double as a primary federal lobbyist for their organizations and/or spend a significant amount of time involved in the

preparation of regulatory policy filings designed to advance the organization's members' interests.

- The General Counsel may be among the longest serving officers in Senior Management. This means that the GC may be the “institutional memory” of the organization.
- The General Counsel, in the best of circumstances, is perceived by all as neutral on “policy issues”, whose position is understood to be to serve the organization as opposed to any one faction or group, i.e. “Switzerland”.
- It is also likely that the nonprofit Board and/or management will turn to the GC to serve as a sounding board for the overall business and strategic plans for the organization. Many of these discussions will not have a predominantly legal component. Rather, the presumed confidentiality that surrounds discussions with a lawyer is likely to cause the executive to feel that he or she can vet ideas (and, in the case of associations, perhaps uncover antitrust concerns) with some degree of comfort.
- The upshot of this is that given the limited legal budget of most nonprofits, the amount of time and money available for required in-house corporate activity is likely to be very limited. The nonprofit GC will find “legal” work subject to severe prioritization pressures. Satisfying the Board, management, organizational requirements, and spurious contract issues are likely to consume the remainder of the GC's time. For this reason, it may be important to establish clear ground notes with respect to the use and allocation of the GC's time and resources.
- This does not mean, however, that the role of the General Counsel, particularly in light of the current fiscal and accounting environment has been reduced in any way. For example, corporate responsibility proposals will affect nonprofit entities. State

Attorneys' General have shown an increasing propensity to focus on nonprofit entities and their fiscal solvency. The IRS continues to have an active nonprofit entity agenda as well.

## II. Dealing with the Media

- The effect of the Media on nonprofit activities can be very positive, offering an important and valuable vehicle to disseminate an organization's message, and assist with fundraising efforts. Or, it can be very negative and unsettle the entire organization.
  - This is true even for organizations that spend considerable amounts on paid advertising.
- At the same time, an organization has to expect scrutiny from the media and be prepared for hard questions, especially when the organization operates in a controversial area, has tough opponents, is facing difficult financial issues, is having governance issues, and/or espouses cutting edge or controversial positions.
- While most public attention has been focused on the for-profit sector, non-profits run a great risk in assuming that they are somehow immune from scrutiny.
- Nor are non-profits immune from crises that often play out in the media. A multitude of nonprofits in the news are fueling even greater scrutiny – AHERF, Allina Health System, The Red Cross, and Inter-Coastal Health System are representative. The experience of the United Way of the National Capital Area is another good case in point. The embattled charity has been the subject of extensive, negative press coverage and is now the target of an FBI investigation for its financial practices.

- Media coverage can exacerbate an institutional crisis or provide a means for addressing it. Some useful materials on crisis management (albeit focused on the private sector) include:
  - Prepare for Crisis, It's Part of the Business:  
<http://www.crisismanagement.com/learning.html>
  - Companies in Crisis: What Not to Do When it All Goes Wrong (Exxon example):  
<http://www.mallenbaker.net/csr/CSRfiles/crisis03.html>
  - Seven Dimensions of a Crisis Communication Management: A Strategic Analysis and Planning Model: <http://www.e911.com/monos/A001.html>
  - Companies in Crisis: What to Do When it All Goes Wrong (Tylenol example):  
<http://www.mallenbaker.net/csr/CSRfiles/crisis02.html>
  - The Tylenol Crisis:  
<http://www.personal.psu.edu/users/w/x/wxk116/tylenol/crisis.html>
- Counsel can contribute to effective media relations by:
  - Making sure that press communications are accurate and do not contain information or positions which could unintentionally jeopardize the organization's interests;
  - Keeping in mind that while a legal perspective is always helpful in focusing the issues and making hard strategic decisions, avoiding legal risks should not trump the organization's broader policy interests.
  - Counsel may also be sensitive to the need for organization with respect to the relationship between internal and external communication efforts, as well as the



need to keep appropriate regulators (e.g. Attorney General Offices and legislators) informed.

- Counsel may also offer a longer term perspective on the message the organization should seek to deliver.

### **III. Addressing The “Big Lawsuit”**

- Managing Litigation Within The Organization Is A Critical GC Function
  - Explaining the issues, the litigation process and the cost of litigation to the Board, management, and the staff will be critical, and will likely have to be repeated.
  - Insuring the organization’s interests, as opposed to its management, is paramount and may be a key function.
    - Making all potential insurance tenders is a high priority.
    - It is important to establish time-based litigation budgets and reports to management.
    - Give consideration early to the nature and possible effects of an audit letter response comment.
  
- Lessons learned in managing mission-oriented litigation:
  - It is key for the leadership of the organization to understand that they call the legal shots. In-house counsel can play the role of “simultaneous translator” between internal decisionmakers (Board, CEO, etc.) and outside counsel. Internal decisionmakers, many of whom are pre-eminent in their fields but not knowledgeable about, and possibly intimidated by, legal issues need to understand the options and strategies and feel empowered to make decisions.

- Outside counsel need to understand that they do not drive the litigation, and must tailor their litigation strategies to serve the interests of the organization.
  - As in other types of litigation when outside counsel is involved, it is key (and a constant struggle) to assure that counsel is doing what is necessary to represent effectively the organization's interests but is not treating the litigation as an open-ended profit center.
  - It is also important to convey that "winning the case" may not be the only, or even potentially the most important goal of the organization. Indeed, it may be only one element in an overall approach to a problem.
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- A social change-driven organization may determine that pursuing its goals through affirmative litigation is a sound and effective strategy. Or, it may find itself the target of litigation by its adversaries. Even in the latter circumstance, it may be able to turn such litigation into a strategic advantage.
  - The American Legacy Foundation, an organization with a mission of decreasing tobacco use in the United States and a core strategy of an edgy and proven-effective teen-oriented countermarketing campaign, truth<sup>sm</sup>, operates in a very visible and contentious environment.
  - Over a period of months last year, Lorillard Tobacco Company threatened to sue Legacy under an evolving variety of theories to challenge all or part of the truth<sup>sm</sup> campaign (depending on the theory). By threatening truth<sup>sm</sup>, Lorillard was taking direct aim at Legacy's ability to pursue effectively its mission.

- After walking away from negotiations undertaken in response to a threatened defamation claim, Lorillard served “notice” on Legacy that it would file suit under the Master Settlement Agreement, the settlement reached between the states and the tobacco companies which, among many other things, provided for the creation of Legacy.
- Legacy chose not to wait to be sued in a forum of Lorillard’s choice and filed suit in its own in its choice of forum, the Delaware Chancery Court. Legacy asked the court for a declaration that Lorillard has no claim against Legacy under the MSA, an agreement to which Legacy is not a party, and in the alternative, that Legacy’s ads do not violate the MSA.
- For additional information about the litigation and Legacy’s approach to it, see the following links on Legacy’s web site:

[http://www.americanlegacy.org/section.asp?Location=content/press/press\\_static/lorillard\\_filing.asp](http://www.americanlegacy.org/section.asp?Location=content/press/press_static/lorillard_filing.asp) and

[http://www.americanlegacy.org/section.asp?Location=content/press/press\\_static/lor\\_del.asp](http://www.americanlegacy.org/section.asp?Location=content/press/press_static/lor_del.asp)

#### **IV. How much risk is too much? How much is just right?**

- The level of acceptable risk in business and legal decisions necessarily flows from the mission of the organization.
- For some of us, particularly in social change organizations, accepting substantial risk is simply part of doing business. Other nonprofit organizations may have missions that make them more risk-averse.

- While lawyers traditionally think in terms of reducing risk, and there are certainly always sensible steps to take in this direction, lawyers do not serve their client well by seeking to alter the organization's mission to reduce risk. The appropriate role of counsel is to provide the best possible risk assessment and let the decision-makers decide. The GC must understand that the nature of the position requires sound legal advice given the facts and goals of the organization.
  - At Legacy, for example, if the tobacco companies were happy with us, we probably would not be doing a very good job in our efforts to cut smoking rates. So we do not make decisions on this basis, even though we well know that we operate in a litigious environment with extremely well-funded, powerful and aggressive adversaries.
  - To attract attention to the cause, organizations increasingly use the internet and other media to promote “edgier” messages. See, e.g., “Now Playing,” The NonProfit Times, July 15, 2002 [www.nptimes.com](http://www.nptimes.com), on the use (and persistence of) web shorts.
- In determining which risks to take and which to avoid, the key challenge is to distinguish between what is important to the organization and what is not. An organization needs to choose its fights and not get distracted by fighting about things that do not really matter to it. Balanced advice is critical.
- An organization that pushes the envelope substantively, e.g., by promoting or funding controversial causes, may want to be particularly scrupulous about minimizing legal/procedural risks in its operations, because it is likely to be subject to greater scrutiny. The nonprofit needs to be aware of and prepared for the possibility that groups

opposed to its activities/mission may file a complaint with the IRS challenging its tax exempt status on technical grounds.

- The starting point for the GC in assessing and managing risk is to identify the potential legal, reputational and other risks, including those internal to the organization, such as employee-related claims, which, according to the July 1, 2002 NonProfit Times, represent the largest component of D&O claims against nonprofits. For nonprofits that may lack access to a complete law library, some of the free on-line resources include ACCA, [www.acca.com](http://www.acca.com), the Council on Foundations, [www.cof.org](http://www.cof.org), the Nonprofit Resource Center at <http://not-for-profit.org/> and <http://www.muridae.com/>

#### **V. Forging an effective and educated Board**

- The Board of a nonprofit has a legal responsibility to the organization to be effective at oversight and overall organization, management, and pursue the mission of the organization. This means that it must exercise good faith, diligence, loyalty, and reasonable care in the stewardship of the organization's mission and the preservation of charitable assets.
- The legal standard for Board members is generally to exercise the care of an ordinarily prudent person in like circumstances, with an ability to reasonably rely on management and experts. See e.g. Mass. Gen. Law Ch. 180 § 6C.
- As the corporate crises of 2002 have amply illustrated, it is often difficult and uncomfortable for Boards of for-profits to discharge their fiduciary duty to the corporation rather than merely rubberstamping management practices. It takes energy,

commitment and courage for Board members to achieve an appropriate balance between supporting and monitoring management. There are comparable tensions in the General Counsel's duty to management and the Board.

- There are special challenges for the General Counsel (and other staff) of nonprofits in working with the organization's Board. Why do individuals agree to serve on nonprofit boards, which offer no stock options or monetary compensation? It is important to understand the intangible rewards—including status, identification with the mission, community service, networking—that may motivate the Board members. How can your organization meet their needs while assuring that they align with the mission and organizational needs of the nonprofit? How can the nonprofit harness their energy and talent, inculcate the culture of the organization and connect board members between meetings, particularly when board members are geographically dispersed? The General Counsel plays an important role in educating Board members about their fiduciary duty and the legal environment, so the Board can make informed decisions to promote the mission.
- BoardSource, at [www.boardsource.org](http://www.boardsource.org), formerly the National Center for Nonprofit Boards, is a rich resource for information and activities to build effective nonprofit Boards.
- Materials General Counsel may wish to read are often available through the State Attorney General in the States where business is conducted. For example, see websites from the Minnesota Attorney General's Office regarding the ongoing investigation of the Allina Health System at: [http://www.ag.state.mn.us/consumer/news/pr/pr\\_allina\\_m](http://www.ag.state.mn.us/consumer/news/pr/pr_allina_m). See

also EO Directors and the Sergeant Schulz Defense, M. Peregreen, 36 *The Exempt Organization Tax Review* 27 (2002).

- It is helpful to review duties and responsibilities of the Board on an annual basis. There are a number of publications that may be helpful in this process. An Attorney General's Guide in your State may be quite helpful. See *Mass. Attorney General's Guide For Board Members of Charitable Organizations*.

#### **VI. Fighting the "nonprofit" mentality of running the organization**

- There are both personal and structural reasons that Boards and staff of nonprofits sometimes forget that the organization has a bottom line. For example, the visionary founder may have hired the senior staff members of the nonprofit because they align with its mission, irrespective of their management and professional skills. Even Board members with considerable business background often see their service to nonprofits as an extension of their philanthropic interests, i.e., a break from the rigors of their for-profit activities, rather than another arena in which to apply their business sense.
- Funders sometimes exacerbate the problem by limiting their support to the marginal cost of projects that are relevant to their own interests, encouraging the growth of program without a corresponding increase in capacity.
- Unfortunately, most nonprofits do not have the luxury of neglecting the bottom line indefinitely. The organization may find that its aspirations have outstripped its funding and that it lacks the financial underpinnings to sustain its program. As the research of the Nonprofit Finance Fund underscores, growth (or even maintenance) of programming requires planned growth of overall resources, beyond those required for the programming

alone, and an appropriate supporting capital structure. See

[www.nonprofitfinancefund.org](http://www.nonprofitfinancefund.org) for monographs and other materials about nonprofit management and financing.

- Because of his/her legal training and perhaps some residual common sense, the GC may be able to provide management and the Board with some tools for financial analysis and planning. Often, however, the voice of reason is best heard when it comes from an outside source such as a consultant. In any event, the health of the organization and its ability to sustain its mission will depend on clear-sighted analysis of its business and finances, complemented by real-world strategic planning.
- Keeping aware of the views and enforcement actions of State Attorney Generals is increasingly important, in particular in the area of waste off charitable assets. Recent actions in Minnesota (Allina Health Systems) and Illinois have focused on such things as:
  1. Excessive personal travel and entertainment expenses;
  2. Failure to properly administer large consulting contracts;
  3. Actions contrary to the mission and purpose of the organization;
  4. Incurring unnecessary Federal taxes or penalties;
  5. Improper management of cash;
  6. Sales of assets at less than fair market value;
  7. Failing to distribute funds thereby not fulfilling charitable obligations;
  8. Payment of excessive salaries; and
  9. Incurring penalties for statutory violations.
- Dissident directors also may file challenges that must be carefully reviewed. See e.g. Eychaner v. Cross, 757 N. G. 2d 969 (Ill. App. Ct. 2001).





## INTRODUCTION

*This Guide is provided by the Attorney General's Office to help board members of charitable organizations, and is particularly meant to assist the board members of charitable corporations and associations in the exercise of your important responsibilities.*

*Often we are asked what we think the most important things are that a board member should do in order to do a good job. Here are our recommendations in key areas of charity stewardship. While this Guide is not intended to prescribe the exact manner in which a Massachusetts charitable board must function, and while we recognize that charities vary greatly in the size, form and structure of their boards, we believe that this Guide will help all board members do their jobs well.*

# THE ATTORNEY GENERAL'S GUIDE FOR BOARD MEMBERS OF CHARITABLE ORGANIZATIONS

**Tom Reilly**  
**Attorney General**



THE COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF THE ATTORNEY GENERAL  
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Dear Board Member:

The Office of the Attorney General offers this guidance to the members of governing boards of charitable organizations, with an appreciation of your willingness to volunteer for service as a charity board member.

You are performing a public service of the highest order, performing a service that helps to meet a critical need in our state. On behalf of the public, this office thanks you for your hard work and dedication.

Sincerely,

Tom Reilly  
Attorney General

## THE BUCK STOPS WITH YOU

If you are a member of the board of a charitable organization, you and your fellow board members are responsible for governing the charity as it carries out its charitable mission. The law imposes upon you two primary duties. The duty of care means that you must act with such care as an ordinarily prudent person would employ in your position. The duty of loyalty means that you must act in good faith and in a manner that you reasonably believe is in the best interest of your charitable organization. As discussed throughout this Guide, it is your job to oversee your chief executive officer and to see that the charity is faithfully carrying out its purpose without extravagance or waste.

This means:

You should attend board meetings and meetings of committees on which you serve. You should make sure that you receive detailed information beforehand about matters which are going to be voted on at a meeting.

You should carefully read all the material which you receive, and prepare yourself to ask questions.

You should use your own judgment, and not simply take the word of your CEO or fellow board members.

In short:

You should be aware of and informed about every major action the charity takes.

## KNOW 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 affecting the provision of charitable services to the community served by 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. If you don't have adequate information, you have the right to get it.

This means:

You have the right to have reasonable access to management.

You have the right to have reasonable access to internal information of the organization.

You have the right to have reasonable access to the organization's principal advisors, such as its auditors and consultants on executive compensation.

Senior management must be willing to facilitate board access to books and records of the charity.

Senior management must be willing to facilitate communications between the board and the principal advisors 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 short:

You have the right to obtain the information you need to carry out your responsibilities as a board member.

## MAKE SURE YOUR BOARD IS VITAL AND DIVERSE

A charity's board should be vigorous and responsive to the mission of the charity. You should make sure that your board's process of selecting new members assures diversity of viewpoints and rotation of board members and officers. As a board member, you have responsibility for ensuring that the public and charitable role of the charity will be carried out in a way that is the most beneficial to the community and the purpose served by the charity. A nominating process which invites openness, variety, and change is important to achieving this goal.

This means:

Your nominating process should reach out for candidates, and actively recruit individuals whose commitment, skills, life experience, background, perspective or other characteristics will serve the charity and its needs.

A larger candidate pool may result if you include non-board members as well as board members on your nominating committee.

Term limits for board members can be an effective way to ensure board vitality. If your board does not have term limits, board members should be reviewed periodically to confirm that they remain interested in and suitable for the board. Rotation off the board, assignments to off-board committees, and designation as emeritus members are other ways to achieve a vigorous board.

In short:

To avoid becoming labeled as a closed club for 'insiders only,' choose board members who have an interest in the charity's mission, represent diverse viewpoints, and have a willingness to learn and then be sure there are opportunities for board renewal.

## KNOW YOUR CHIEF EXECUTIVE OFFICER

Hiring the charity's CEO is one of the most important tasks you have. It is the job of the board to engage in a selection process which will allow the board to find the right person to carry out the charity's purpose efficiently and effectively. The charity for which you are responsible can only benefit when the entire board participates in hiring and evaluating its chief executive employee.

This means:

The board should form a search committee at the beginning of the hiring process.

A majority of the search committee members should be board members, but it may be beneficial to include staff members and other able people.

The board should develop a profile of the person most likely to succeed as CEO of the charity it oversees, and look for someone who matches the profile.

If the size of the board permits, the entire board should interview the final candidates and participate in contacting their references.

The entire board should make the final decision to hire the CEO.

After the CEO is hired, the board should periodically review and assess the chief executive's performance, keeping in mind that the board has the authority to discharge as well as hire the CEO.

In short:

Board members should actively participate in selecting and evaluating the charity's CEO.

## GET INVOLVED IN SETTING EXECUTIVE COMPENSATION

The board is responsible for setting the compensation of the charity's chief executive employee. When setting CEO compensation, you should be mindful that the public, which supports the charity and uses its services, is interested in knowing the amount. This information is public in Massachusetts and is on file at the Division of Public Charities, Office of the Attorney General, One Ashburton Place, Boston, MA 02108.

This means:

Every board member should know what the CEO is paid. If the CEO is receiving a compensation package, you should know what it includes and its monetary value.

Even if a compensation committee is used, it should not make the final decision.

In setting compensation, the performance of your CEO and salary scales and fringe benefits of other similarly situated executives in the field are factors to consider.

You should remember that CEO compensation is important to the donors of funds, the beneficiaries of the charity, and the community at large.

In short:

Your process for setting CEO compensation, the amount of such compensation, and the terms of such compensation should all be approved by the full board and be sensitive to public concerns.

## BEWARE OF CONFLICTS OF INTEREST

You, or a business you control or benefit from financially, may be considering whether or not to engage in a transaction with the charity on whose board you are sitting. A situation of this type presents a potential conflict between your own financial interests and your duty as a board member to be absolutely loyal to the charity. It also may look questionable to the public.

Because of these problems, a board member or related entity should be cautious about entering into a business relationship with the charity the board member is overseeing, and the board should be very cautious about allowing the charity to enter into such a relationship. Such a transaction should not occur unless the board determines it is clearly in the best interest of the charity. Prior to the board vote, the board member should fully disclose his or her financial interest to the entire board, and the board member should not vote on any aspect of the arrangement or be present when it is being discussed or voted upon.

This means:

You should ensure that your board has a policy for dealing with conflicts of interest.

The policy should include a procedure for the annual written disclosure by all board members of their business involvements with the charity and their other board memberships, both for-profit and charitable. The information disclosed should be circulated to all board members and be updated throughout the year as necessary.

Your conflict-of-interest policy should address the issues raised if board members have or might acquire investments that may affect or be affected by the charity's investment decisions.

The policy should also include a procedure for the following: disclosure of financial interest, and withdrawal from discussion and voting by the involved board member. This policy should be followed whenever the charity enters into a business transaction with a board member or with an entity in which a board member has an interest.

It may be advisable to obtain an outside evaluation of any major business transaction which is being proposed between the charity and a board member or an entity in which a board member has an interest. This evaluation is to assure that the proposal is feasible, the terms are favorable to the charity, and the potential pitfalls of such a transaction have been considered.

Because of the sensitivity of conflict-of-interest issues, you may want to require that transactions involving these issues receive a greater-than-majority vote.

The Attorney General recommends that conflict-of-interest policies require that each board member make an annual disclosure to the entire board of the total amount the board member received from the charity during the previous year as a vendor of goods to the charity or on account of services rendered to the charity. Massachusetts law already requires this disclosure to be made on the annual reporting form filed by the charity.

In short:

Any conflict transaction should be scrutinized very closely by the board, both because of the dynamic it creates within the board and because of the predictable skepticism with which the public will view the transaction, no matter how scrupulously a careful policy is followed.

## FOLLOW THE MONEY

As a board member you have primary responsibility for making sure that the charity is financially accountable, has mechanisms in place to keep it fiscally sound, operates in a fiscally sound manner, and is properly using any restricted funds it may have.

This means:

The board should make sure that a realistic annual budget is developed.

The budget should be developed early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year.

The board should be sure that the charity has adequate internal accounting systems.

Board members should expect management to produce timely and accurate income and expense statements, balance sheets and budget status reports and should expect to receive these in advance of board meetings.

The board should require periodic confirmation from management that all required filings (such as tax returns and the Massachusetts Form PC) are up-to-date and that employee withholding taxes and insurance premiums are being paid when due.

The board should consider the value of maintaining standing audit and finance committees.

The board should make sure that fundraising is done honestly and with integrity. The board also should make sure that any contract with an outside professional fundraiser is fair and reasonable, and that the fundraiser's performance is monitored.

The board should confirm that any restricted gift to the charity is separately accounted for, and that the funds are being used in accordance with the terms of the restriction.

In short:

The board should be involved and informed in all aspects of the finances of the charity.

## EDUCATE YOURSELF

A member of the board of a charity should be knowledgeable about his or her role in the governing process, the mission of the charity, and the unique operational and financial issues which face the charity.

This means:

You should have a copy of and be familiar with the articles of organization of your charity and the by-laws of your board.

You should make sure that board education programs are offered regularly.

Particular attention should be given to providing educational opportunities for new board members.

Programs should draw on the expertise of specialists in the fields related to your board responsibilities.

If your board does not have a board manual containing governing documents and other orientation material, it may want to consider developing one.

In short:

As a board member, you must take the initiative to educate yourself on an ongoing basis about your role and responsibilities.

## WHERE THIS GETS YOU

If you follow the advice provided here, you will be a productive and effective member of your board. You will have taken the right steps to guard against the possibility of a lawsuit because of disregard or neglect of your duty of loyalty or your duty of care. And you will experience the rewards and personal satisfaction that come with a job well done.

## RESOURCES TO ASSIST YOU IN YOUR RESPONSIBILITIES

For a detailed list of books, pamphlets and articles on the responsibilities of charity board members, and a collection of other relevant materials, call the Division of Public Charities in the Office of the Attorney General (617-727-2200 x2101) and ask for the Board Members' Packet.

For training programs, technical assistance, and access to a resource library, call the New England Institute for Non-Profits at Tufts University (617-627-3549).

For management training workshops, call the Technical Development Corporation (617-728-9151).

This Guide was developed with the assistance of the Attorney General's Advisory Committee on Public Charities, whose valuable help is gratefully acknowledged. Since this Guide is not a summary of the law and is not intended as a substitute for legal advice, we suggest you consult qualified legal counsel if specific questions arise concerning matters addressed by the Guide.



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