Nonprofit Board Excellence:

Building a More Informed and Accountable Board

A training workbook for boards of directors with a focus on nonprofit organizations in Washington State

This workbook is the product of a fellowship from the Scottish Rite Scholarship Foundation of Washington

It has been modified for general use

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This workbook is the product of a graduate student fellowship with the Nancy Bell Evans Center on Nonprofits & Philanthropy at the University of Washington's Daniel J. Evans School of Public Affairs. The Scottish Rite Scholarship Foundation of Washington funded the fellowship. The workbook was compiled by Trisha Matthieu under the advisement of Professor David Harrison. For questions or comments about it, please contact Trisha at *tmatth@u.washington.edu*. The aim of the Nancy Bell Evans Center on Nonprofits & Philanthropy is to enhance the understanding and vitality of the nonprofit sector through research, education, and community engagement. For more information, visit *www.evans.washington.edu/research/centers/nbec.php*.

Special thanks are extended to the Scottish Rite Foundation for its generous permission to modify this document for general use for all Washington State nonprofits.

In addition, there are numerous individuals and organizations in Washington State whose vast work regarding nonprofit boards has made this workbook possible. These organizations can be found listed in the resources section and though they are too numerous to mention here, their work on this topic has been invaluable and they should be properly acknowledged. Thank you.

Welcome and Thank You!

Thank you for volunteering *your time, energy and wisdom to serve on a board of directors for a nonprofit organization. As a director of a nonprofit, you are making an important contribution to the organization and to your community. Whatever your skills and interests, you have valuable assets that are vital in ensuring that your organization is meeting its mission and helping your community.*

Nonprofit organizations in this country are at a critical turning point. There are ever new and expanding community needs to serve. Many organizations have the challenge of declining rolls and the desire to help more people with fewer resources. And now, recent corporate and nonprofit misdeeds have led to new government accountability requirements and the increased need for all organizations to put internal controls in place and to be more open to the public.

Your organization cannot respond to these changes without a committed board of directors, willing and able to govern and guide it. This responsibility, however, need not be overwhelming. By first gaining an overview of what you need to know and what is expected of you, the process will be much more manageable and rewarding.

This workbook provides the basic information that every board member should know about what is required of nonprofit organizations in our state in order to stay in compliance, meet new demands, and protect both the organization and those it serves. It also provides information on the role of the board, as well some basics to understanding the organization's finances. We appreciate your time and willingness to work through the provided materials. We hope you find this workbook useful to you while serving in your important role.

Thank you for helping.

NOTHING IN THIS WORKBOOK CONSTITUTES LEGAL, ACCOUNTING, OR TAX ADVICE. THE MATERIAL CONTAINED HEREIN IS GENERAL INFORMATION FOR EDUCATIONAL PURPOSE ONLY. YOU MUST CONSULT AN ATTORNEY OR ACCOUNTANT FOR YOUR PERSONAL OR ORGANIZATIONAL NEEDS.

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Introduction
Why This Workbook?

SCENARIO A

The College Yes! Foundation, a local nonprofit that provides college scholarships to high school seniors with financial need, has just declared bankruptcy. Though it had been supported by numerous generous donors and by membership fees with partner organizations, a series of organizational mishaps converged to force the company to close.

The first discovery of wrongdoing occurred when one of the funders asked for a financial audit to be done so that they could insure their money was going where they had intended it to go. The audit revealed that the organization's Treasurer had been writing checks to pay for his wife's hospital bills. Since he was the only check signer on the account, as well as the one who provided financial updates to the board, nobody had noticed what he was doing.

Soon after, the IRS discovered that the foundation had not filed a tax return in two years and that they had taxable income. This resulted in the organization paying a hefty fine, along with past due taxes for sales of goods not related to the organization's mission.

Finally, the organization was sued for discrimination by one of the students who did not receive a scholarship. The organization's board was found guilty and had no liability insurance. They were forced to close their doors to pay the settlement fee.

THIS IS CERTAINLY AN EXTREME EXAMPLE, but do any of these issues make you wonder about your own board's knowledge and responsibilities? Is your board set up in a way that ensures there are safeguards in place? Does each member know the basics of what must legally be filed and reported each year so that if one member were to leave, the institutional knowledge and capacity would remain?

Research shows that the quality of a nonprofit's board of directors is one of the most important factors in how effective that organization will be. And nonprofit organizations, such as yours, are making efforts to do better. However, there are several signs that indicate many nonprofit boards are still in need of improvement[1]:

- The majority of nonprofit boards are now comprised of individuals with no prior board experience. In 1998, some 70% of those serving on America's nonprofit boards had less than two years of board experience. And, at least half of the country's nonprofits do no board orientation or training.

- Legal fees for nonprofits are skyrocketing with most of this increase due to cases that could have been avoided had boards established appropriate policies.

- And, a 1999 survey by the Independent Sector showed that 28% of Americans do not believe that nonprofits are honest and ethical in their use of donated funds!

[1] This section quoted from a Seattle University Executive Masters Nonprofit Leadership Program training module.

Your nonprofit board may be especially vulnerable. Many organizations are run primarily or even entirely by volunteers, with the board of directors rather than a paid staff managing the organization's resources. Busy individuals with a wide range of talents sometimes join without prior board experience. Some have little or no training in financial management and are not quite clear on the reporting requirements. Others assume that because an organization may be small, improprieties are unlikely and if they do happen could not be missed.

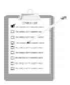
For the most part, many nonprofit boards have been able to function with relative ease. There is often at least one person who is a CPA or a lawyer who can handle the legal and financial issues as they arise. However, because of the changing nature of the nonprofit sector, with more openness required and lawsuits a bit more likely to threaten at the doorstep, it is imperative now, more than ever, that each board is practicing due diligence.

How to use this Workbook

This workbook is designed to provide you with the information you need to be an effective board member and to help keep your organization squeaky clean.

Scenarios describe situations currently facing nonprofit boards and are used to illustrate the ways in which board due diligence can be critical to the health of your organization

The Roles and Responsibilities of you  and your board  are highlighted.



Forms, including Charts and Financial Statements that you may encounter are also included, along with explanations of how to understand and use them.

Exercises provide you with the chance to think about and apply what you've learned so that it becomes meaningful and useful to you. As you work through these exercises, write down questions and actions for you and your board in the "Action Plan" on pages 89 and 90.

Key Learning Outcomes

After reading and working through this workbook, you will:

- Understand your responsibilities as a nonprofit board member.
- Be aware of the organization's legal requirements and the board's role in guaranteeing compliance.
- Comprehend changing accountability requirements in the nonprofit world and the types of accountability measures your organization should consider.
- Recognize organizational and personal liability issues you may encounter and know how to protect the organization and yourself.
- Have some basic finance skills around understanding and using key financial statements and the relationship of these skills to board accountability.
- Perceive what board excellence looks like for you and your board.
- Know where you can get more assistance and training.

Some Definitions to Guide You

For the purposes of this workbook, **DIRECTOR, BOARD MEMBER AND TRUSTEE** are all used interchangeably to mean the governing body of a nonprofit organization.

Likewise, **NONPROFIT, CHARITABLE ORGANIZATION AND TAX-EXEMPT ORGANIZATION** are all used to refer to 501(c)(3), (c)(2), (c)(4) and other such organizations. These are the categories of federal tax-exempt status that many nonprofit organizations fall into and are discussed later in this workbook.

- **DUE DILIGENCE:** Due diligence is the level of judgment, care, prudence, determination, and activity that a person would reasonably be expected to use under particular circumstances.

- **FIDUCIARY:** A fiduciary is an individual, corporation or association holding assets "in trust" for another party, often with the legal authority and duty to make decisions regarding financial matters on their behalf. The Fiduciary has the duty to act in the best interests of another party. Board members of nonprofit organizations are considered fiduciaries because of their obligation to their donors and to the public to manage funds appropriately.

- **INDEMNIFICATION:** Indemnification is the promise of the organization to cover the legal expenses/judgments incurred by a board member as a result of their board service.

- **INTERNAL REVENUE CODE (IRC):** This code consists of the laws governing taxation in the United States and is administered by the Internal Revenue Service.

- **NONPROFIT STATUS:** Nonprofit status is an incorporation status under Washington state law. It is granted to those corporations "no part of the income of which is distributed to members, directors, or officers." The word "nonprofit" often confuses people; a nonprofit CAN make a profit. It just cannot distribute the profit to the board or members. You may more frequently see "not-for-profit" used to clarify this distinction.

- **REVISED CODE OF WASHINGTON (RCW):** The Revised Code of Washington is the code that makes up Washington State law.

- **TAX-EXEMPT STATUS:** Tax-exempt status refers to federal income tax exemption under the Internal Revenue Code and has to be applied for separately than state nonprofit status. Organizations do not have to pay federal taxes on income related to their mission, but are not immune from all taxes, depending on the actions of their organization. Charitable contributions made to organizations with 501(c)(3) tax-exempt status are tax deductible for the individual or organization.

- **WASHINGTON ADMINISTRATIVE CODE (WAC):** The Washington Administrative Code consists of the State agency rules and regulations that are used to implement State law.

EXERCISE A

Consider the following:

Ten common legal mistakes of nonprofit boards

1. Thinking income tax exemption means the organization is exempt from all taxes
2. Difficulty separating board and staff work
3. Failure to follow corporate structure—articles of incorporation, bylaws, statutes
4. Unfamiliarity with reporting requirements
5. Understanding a nonprofit mission but not understanding running a business
6. Thinking the organization has income tax exemption when it does not
7. Failure to observe public support rules (such as what percentage of support must be from the general public.)
8. Federal government Form 990 reporting requirements entirely overlooked or completed in error
9. Failure to properly educate board members about roles and responsibilities and expectations
10. Failure to disclose or appropriately deal with conflicts of interest

Read the list again and think about your own board. Circle the numbers of any of these mistakes you think your board might be making. Write down any additional mistakes not currently on the list.

ACTION PLAN: Add the items you want to check in with your board about to your Action Plan on pages 89-90.

Part I

Board of Directors' Role & Responsibilities

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Part I
Board of Directors' Role & Responsibilities

SCENARIO 1

The organization Books for Kids is holding its summer board meeting, and you're a member of the board. It is a nonprofit that provides new books to children as well as pairs up volunteer tutors with struggling elementary school readers. The organization operates under a fairly small budget and is always looking for ways to save money.

Your attention in the meeting is currently focused on two discussion items. First, the organization has recently received a large grant to buy a huge number of new books over a period of three years. Mary, a current board member, has a brother who owns a bookstore and she is proposing that an arrangement be worked out where all of the books are bought through his store. As a result, he would give the nonprofit a great discount.

The second item centers around Stan. Stan, another director, has decided to switch professions from teacher to graphic designer. He wants to start a new business out of his home and has asked the organization to loan him some money to buy a computer. With the computer, he would then be able to do a lot of pro bono design work for their organization, including the new recruitment flyers that they had just gotten a few high-cost bids to outsource.

Both requests seem reasonable to you. Each would save the organization money, keep the work in house with people you know and trust, and seem to benefit all around. Your board prepares to vote on the two items.

WAIT! DON'T VOTE YET. Not until you have more information. This section discusses the various roles and responsibilities of nonprofit board members and the board of directors as a whole. It discusses what you as a board member are expected to do, how to care for and govern your organization and what your legal obligations are. You may be surprised to learn that some of the things you've been doing for years could get you into trouble one of these days if the proper policies are not put in place.

Qualities of a Board Member

Every board member should possess the following:

- **Integrity**. Be a moral force to keep the organization on the straight and narrow, doing nothing improper at any time.
- **Judgment.** Help the board choose the right course of action.
- **Perspective.** Help the board, and the organization, keep their balance through both adversity and acclaim.
- **Courage.** Hold firm to your belief in the organization and in the steps it must take to fulfill its mission.
- **Creativity.** Stimulate other board members and any staff with constructive ideas that challenge everyone to think creatively for the organization.
- **Dependability.** Show up at all times when needed.
- **Stability.** Be known as one who is always prepared.
- **Focus.** Keep yourself and the entire board focused on the purpose of the organization.
- **Sensitivity to Diversity.** Demonstrate respect for minority issues and a willingness to deal with them.

--Golding & Stewart, Inside the Nonprofit Boardroom

Chapter 1

What are the Legal Responsibilities of the Board of Directors?

QUICK GLANCE
The law imposes upon you two primary duties.
- 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.
- The ***duty of due care*** means that you must act with such care as an ordinarily prudent person would employ in your position.

The Buck Stops With You!

As a member of a nonprofit board, you and you fellow board members are responsible for governing the organization as it carries out its charitable mission. However, did you know that this is actually mandated by law? Since nonprofits are responsible to the public due to their special tax exempt status, the legal obligations of nonprofit boards are set through a combination of federal and state laws to ensure that the public trust is not violated. As a director of a nonprofit organization and a fiduciary, you have both authority and responsibilities under the law. There are two general areas of regulations that you should know. First is the overall role of the board defined as the *General Duty to Manage Corporate Affairs*, and second, is the *Standard of Care*, which covers individual responsibilities including the Duty of Loyalty and the Duty of Due Care.

> *The ultimate responsibility lies with the board members—to show up at meetings, to pay attention, ask "impertinent" questions, act in good faith, and use their best judgment in the pursuit of the mission of the organization.*
> --Carol Weisman,
> *Secrets of Successful Boards*

A Note About Staff Versus Board Responsibilities:

Boards govern. Staffs manage. Before proceeding, it is important to note that there is often confusion among board members and staff as to who should perform which duties. This is generally an organizational structure issue and there are different governance models available to help guide an organization to creating a structure that's right for your organization. Because the vast majority of nonprofits in Washington State have very few staff members or only volunteers, this issue is not explored in detail in this workbook. However, it is relevant to note that regardless of the makeup of your organization, the board has the ultimate governing responsibility. Therefore, though staff may be actively involved in the decision-making process, it is important that the board has the ultimate say and responsibility on such key items as hiring the executive director and auditors, giving final approval to budgets and making big picture organizational strategic decisions. These obligations are discussed more in later chapters.

General Duty to Manage Corporate Affairs

The principal legal framework for nonprofits in Washington is the Washington Nonprofit Corporation Act (the "Act"), which is the Revised Code of Washington (RCW) Chapter 24.03. Under the Act, a corporation's board of directors is the governing body of the corporation and its most basic duty is to "manage the affairs of the nonprofit corporation" (RCW 24.03.095). The following items are what you should do to ensure you are fulfilling this duty.

What is your role as a director?

*To **manage the affairs** of the organization, as a director you should:*

- Attend meetings and special events.
- Be informed about the organization's mission, services, policies, and programs.
- Review agenda and supporting materials prior to board and committee meetings.
- Serve on committees and offer to take on special assignments.
- Make a personal financial contribution to the organization or raise a designated amount.
- Inform others about the organization.
- Assist the board in carrying out its fiduciary responsibilities, such as reviewing the organization's annual financial statements.
- Ask and answer questions that get at financial and legal issues, such as "Have we paid our taxes?" "Is this program in line with the organization's tax-exempt purpose and goals?" "What do we do in the face of declining membership?"

What are the board's responsibilities?

*To **manage the affairs** of the organization, your board must:*

- Determine the nonprofit corporation's mission, purposes and goals.
- Adopt operational policies and procedures and ensure effective organizational planning by the staff (if organization has staff).
- Ensure adequate financial resources.
- Manage and monitor resources effectively, approve budgets, and establish fiscal policies and financial controls.
- Determine, monitor, and strengthen programs and services.
- Serve as public representatives of the nonprofit corporation and enhance its public standing.
- Recruit and train new directors and regularly assess board performance.
- Maintain the nonprofit corporation's good standing with the IRS and the Secretary of State.
- Ensure legal and ethical integrity and maintain accountability.
- Select the executive director (where relevant), define his or her duties, set compensation, and review performance on a regular basis.

The Standard of Care

In addition to responsibilities of the board as a whole, Washington law sets forth individual duties for directors of nonprofit organizations. The Act imposes a certain "standard of care" on board members including the **duty of loyalty** and the **duty of due care**. Board members must perform their duties as a member of the board and as a committee member *"in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstance."*

Duty of Loyalty

The duty of loyalty is a standard of faithfulness; as a board member and a fiduciary of the organization, you must give undivided allegiance when making decisions affecting the organization. This means that a board member can never use information obtained as a member for personal gain, but must act in the best interests of the organization.

Directors must avoid conflict of interest.

Directors must always act for the benefit of the nonprofit corporation. The Act disallows any conflict of interest arising from a situation where a director or their family member benefits from the director's position on the board, financial or otherwise. While some situations may seem innocent or fair, conflicts of interest should be avoided because they represent a potential breach of the duty the director owes the corporation. In the event that a conflict of interest cannot be avoided, the conflict should be disclosed to the Board and the director should abstain from the discussion and the vote. The director's abstention also should be recorded in the minutes. Even if a conflict of interest exists, the board of directors may make a decision that is favorable to the interested director if the decision is in the best interests of the nonprofit corporation. See Appendix K, page 104, for a Sample Conflict of Interest Policy.

Loans to other directors

The corporation may not make any loans to its directors! It is ILLEGAL in Washington State (RCW 24.03.140). Any director or officer engaging in such a transaction and any director or officer participating in the making of such a loan or extension of credit is liable to the corporation for the amount of the loan until it is paid.

Directors must maintain confidentiality.

Information exchanged and discussed at board meetings is confidential and should not be discussed with outside third parties. If directors are serving on the board as representatives of other organizations, the confidentiality policy should be put in writing.

What is your role as a director?

To practice the ***duty of loyalty****, as a director you:*

- ♦ Must avoid conflict of interest.
- ♦ May not make any loans to other directors.
- ♦ Must maintain the confidentiality of private corporate affairs

What are the board's responsibilities?

To practice the ***duty of loyalty****, your board should:*

- ♦ Evaluate existing programs to determine if they are run efficiently and examine financial statements to ensure the corporation has adequate funds to pay its debts and that those funds are being used to further the organization's goals and mission.
- ♦ Require the disclosure of any potential conflicts of interest.
- ♦ Require the approval of any potential conflict of interest by a disinterested majority of the board.
- ♦ Have a policy in place that forbids loans to directors
- ♦ Ensure that accurate recordings of votes are made in meeting minutes.
- ♦ Ensure that directors know what board business should not be disclosed to outside parties.

Duty of loyalty issues most often arise when a board member is involved in an "interested" transaction such as "self-dealing" or when a Board member is on both sides of a transaction. This could happen when a board member is both the seller (as an individual) and the buyer (as a Board member) in a sales transaction. This is especially common in small organizations where board members want to give deals to the organization they know needs help.

Take, for example, a nonprofit, that has a board member who is a printer and can provide discount printing to the organization. This organization might addresses this potential conflict of interest by having a policy in place that requires the board to get three vendor estimates for print jobs over $100 and to choose the vendor with the lowest price. If the board member comes in at the lowest price, they can be used. Because this policy is in place, the organization would be following a procedure, rather than making subjective decisions. A policy such as this should also specify that the board member who is also a vendor is not able to see the competing bids and that the board member recuse himself from voting on approving the contract.

Duty of Due Care

The duty of due care relates to the level of competence expected of directors. A director must not only act in good faith but also *"with such care, including reasonable inquiry, as an ordinary prudent person in a like position would use under similar circumstances."* (RCW 24.03.127)

Prudent person

The Act acknowledges that board members are not expected to be experts in every issue that comes before the Board. In performing your duties as a director, you may rely upon information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by:

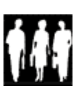
- An officer or employee of the corporation whom the director believes to be competent and reliable in the matter presented;
- Professionals or experts such as attorneys, public accountants or others, if the matter is within that person's expertise; or
- A committee on which the director does not serve, if the matters are within the committee's designated authority. (RCW 24.03.127).

However, keep in mind that reliance on such information does not excuse the director from exercising reasonable inquiry and acting as a prudent person!

What is your role as a director?

To practice the ***duty of due care****, as a director you should:*

- Ensure that whenever directors make a decision, especially a controversial one, it is done with proper written documentation showing that each person acted with good intentions.
- Attend board meetings regularly
- Read minutes of meetings and reports presented by officers
- Exercise independent judgment when voting
- Ask questions
- Participate in discussions and decision-making
- Remain informed about the nonprofit corporation's affairs, programs and activities.
- Require that financial reports and budgets be produced
- Review financial information and evaluate the appropriateness of expenditures, including salaries and other forms of compensation.



What are the board's responsibilities?

To practice the ***duty of due care****, your board should do the following:*

- Study and understand issues and consider information, opinions, reports, statements prepared and presented by appropriate professionals or authorities and then create records that reflect these activities.
- Build expertise into your board so that you are not forced to over-rely on experts. However, directors should never rely solely on the opinions of other directors who are not recognized as authorities or experts on important issues brought up for board consideration.

- Act in good faith, which often depends upon the personal intent of the director in question.
- Know that the complexity or magnitude of the problem or decision may affect the determination of whether or not the director acted as an ordinarily prudent person.
- Know when expertise is required and then obtain it, although directors themselves need not exercise greater skill or expertise than an ordinary prepared person.
- Understand that directors who are professionals may be held to a higher duty if they offer opinions in their professional capacities.
- Not be scared to take risks and make mistakes when intentions are good.
- Know that the duty of due care is an active duty. Directors cannot avoid liability by claiming ignorance of corporate affairs. ***Ignorance is not bliss*** in this case and can expose the organization to damage claims.

> The Act does not require directors to attend board meetings. However, directors who are frequently absent from meetings are not fulfilling their fiduciary duty and risk violating the duty of care. Some organizations are so concerned about absenteeism that they include a provision in their bylaws that a director who is absent a certain number of times shall be deemed to have resigned from the board.

Other Formal Board Duties

An organization's articles of incorporation, bylaws, policies and procedures, resolutions and donor agreements should further define the specific duties of any board. The bylaws contain all of the rules by which the nonprofit is governed and operated and the board has the authority to adopt, alter, amend, and repeal bylaws. (RCW 2.03.070). Most nonprofits also have written operating policies and procedures that cover topics such as personnel, fund raising, financial management, and expense reimbursement. Your board of directors may also adopt written resolutions to approve one-time contracts, hire investment advisors, or grant check-writing authority.

Acting within the scope of corporate purpose and authority

As a director, you may act on behalf of the corporation, but only within the scope of authority prescribed by governing documents of the organization (RCW 2.03.127). In fact, you and the other directors **must *ensure that the entire corporation acts within the scope of its purposes clause in the articles of incorporation***. Generally, directors must act collectively through board meetings or with written consent of all board members. Minutes and records of all board and committee meetings should be kept as a part of the permanent corporate records in order to document that proper procedures have occurred.

Voting and quorums

A quorum is the minimum number of directors or members required to be present in order to hold a legal vote. Governing documents often specify a minimum and/or default percentage that will constitute a quorum. However, if the governing documents are not specific, then the "act of a majority of the directors present at a meeting at which a quorum is present shall be the act of the board" (RCW 24.03.110). Washington law also does not permit directors to vote by proxy unless members are specifically permitted to do so by the nonprofit's articles of incorporation or bylaws (RCW 24.03.085).

- One sign of a board in trouble is when groups consistently are not able to obtain a quorum at meetings, and therefore cannot officially make decisions. It is important to revisit these rules to ensure they are still working for your board.

The differences between nonprofit & for-profit board duties

Nonprofit, for-profit and government entities in the United States all have boards of directors that are charged with similar duties and that appraise how well the organization is fulfilling its mission. However, the board of a nonprofit organization has a few distinguishing features.

- The board is responsible to the organization's members, donors, funding agencies, the government and taxpayers, as opposed to shareholders and the organization is prohibited from issuing shares of stock.
- The organization is not driven by the bottom-line, which makes the board more mission-focused. Part-time volunteer members, who may have had little experience with prior boards, are also often a key component of nonprofit boards.
- Small nonprofit organizations without staff have a further distinguishing feature. Without an executive manager and staff, these volunteer boards are responsible for the day-to-day management of the organizations in addition to the traditional duties such as developing strategic plans, approving budgets, and amending bylaws.

Liability of Directors to Outside Parties

Due to the legal obligations discussed above, as a director, you have potential liability to persons outside the corporation if you fail to perform your duties with due loyalty and due care. The "Act" provides that a board member or officer is individually liable for any discretionary decision or failure to make a discretionary decision within his or her official capacity as director or officer if the decision or failure to decide constitutes **gross negligence**. Details about liability and how you can protect the organization, the board, and yourself are discussed in detail in Chapter 9.

What Happens if You Don't Comply with the "Act"?

The nonprofit corporation, its directors, its officers, its members or the state Attorney General may enforce the duties of loyalty, due care and obedience.

EXERCISE 1

Rate yourself on how well you currently do the following by filling in the blank with: Poor, Average, Good or Excellent.

- Attend board meetings regularly. ________________
- Am informed about the organization's mission, policies and programs. ________________
- Read minutes of meetings and reports presented by officers. ________________
- Exercise independent judgment when voting. ________________
- Ask questions. ________________
- Participate in discussions and decision-making. ________________
- Remain informed about the nonprofit corporation's affairs, programs and activities. ________________
- Serve on committees. ________________
- Review and understand financial reports and budgets. ________________
- Review financial information and evaluate the appropriateness of expenditures, including salaries and other forms of compensation. ________________
- Inform others about the organization. ________________

For each item that you marked "Average" or "Poor", how can your board help you to do better?

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► **ACTION PLAN: Add the items you want to talk with your board about to your Action Plan on Page 89. If there are things you want to personally work on, add those to Page 90.**

Part II

Legal Requirements for Nonprofits

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Part II
Legal Requirements for Nonprofits

SCENARIO 2

Frank was a newly appointed director to his nonprofit board. As an experienced board member, he asked to see the articles of incorporation and bylaws of the organization so that he could understand the rules governing this board and the organization. After reading through the documents, he noticed that the organization had been registered as a 501(c)(4), Civic League, Social Welfare Organization or Local Association of Employees under the Internal Revenue Code, which puzzled him, as he knew that the organization did not fall under that category.

Eventually he realized that it had been incorporated incorrectly, and that it should really be a 501(c)(7), Social and Recreational Club. In addition, he noted that the organization had not been paying licensing fees and found that the license had expired. As a result, the organization needed to be incorporated all over again.

THE SITUATION DESCRIBED ABOVE IS MORE COMMON THAN IT MIGHT APPEAR. Tax codes and forms can be tricky, and can change over time. It's important to ensure that you have been incorporated correctly and have been filing your paperwork accordingly. This is the foundation of your organization. Should you ever find yourself in the situation of being audited by the federal government, the Washington Secretary of State, or the Attorney General's office, if you have not been incorporated correctly or have not been paying the appropriate fees and taxes, this could result in fines and a paperwork headache for your organization, not to mention potential liability issues that could affect you personally.

QUICK GLANCE
Boards must ensure organizations have been incorporated correctly with the Secretary of State and have filed for and received federal tax-exempt status. On an ongoing basis, they must file a yearly Form 990 with the IRS and with the State, pay relevant fees and taxes, and restrain from activities that would jeopardize their tax-exempt status. See Appendix A, page 92, for a list of helpful IRS Publications.

Chapter 2

What Type of Nonprofit Organization Should You Be?

A nonprofit corporation is an organization formed for the purpose of serving the public or for mutual benefit other than the pursuit or accumulation of profits. Congress and the Internal Revenue Service have determined that only specific types of organizations can qualify to be nonprofit, or tax-exempt organizations.

Types of Tax-exempt Organizations

There are approximately 30 categories of tax-exempt organizations under the Internal Revenue Code (IRC), and most are listed in Form 1 below. Out of all of them, 501(c)(3) organizations are the most numerous.

► 501(c)(3) Charitable Organizations

A 501(c)(3) organization is referred to as a "charitable" organization. It is the most preferred category of tax-exempt organizations in the IRS code. Contributions to a 501(c)(3) organization are deductible by the donor for income tax purposes, which makes it easier for these organizations to attract funds than it is for non-profits who do not have this status. This code section recognizes as tax-exempt: *"corporations, and any community chest, fund, or foundation, organized and operated exclusively for*

- *religious, charitable, scientific, testing for public safety, literary or education purposes, or to foster national or international sports competition… or for the prevention of cruelty to children or animals,*
- *no part of the net earnings of which inures to the private benefit of any private shareholder or individual,*
- *no substantial part of the activities of which is carrying on any propaganda, or otherwise attempting to influence legislation..,*
- *and which does not participate in, or intervene in (including the publishing or distributing of statements), and political campaign on behalf of (or in opposition to) any candidate for political office." IRC § 501(c)(3).*

► Tax-Exempt Organization Reference Chart

This table, derived from *IRS Publication 557: Tax-Exempt Status for Your Organization (1997)* and compiled by Eric Metzer, may not include every type of organization that qualifies for some form of federal tax-exemption. It should not be considered legal advice or otherwise used to determine matters of law, and is provided for educational purposes only. Please use official IRS materials to insure your information is completely up-to-date and accurate.

Form 1—Tax-Exempt Organization Reference Chart

Section of Tax Code	Description of organization	General nature of activities	App Form	Annual return required	Contributions allowable
501(c)(1)	Corporations Organized Under Act of Congress (including Federal Credit Unions)	Instrumentalities of the United States	No Form	None	Yes, public purposes
501(c)(2)	Title Holding Corporation For Exempt Organization	Holding title to property of an exempt organization	1024	990 or 990EZ	No
501(c)(3)	Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations	Activities of nature implied by description of class of org	1023	990, 990EZ, or 990-PF	Yes, generally
		All 501(c)(3) organizations are further categorized as one of five types under IRC 509(a):			
		Sub-class	**Description**		
		Private foundations	All 501(c)(3) organizations that don't qualify as public charities. Some private foundations are additionally sub-classified as private operating foundations or private non-operating foundations, which receive some of the advantages of public charities.		
		Public charities	509(a)(1)- Publicly-supported charities. 509(a)(2)- Exempt purpose activity-supported charities. 509(a)(3)- Supporting organizations for 509(a)(1) or 509(a)(2) charities. 509(a)(4)-Public safety charities.		
501(c)(4)	Civic Leagues, Social Welfare Orgs, and Local Assoc of Employees	Promotion of community welfare; charitable, educational or recreational	1024	990 or 990EZ	No, generally
501(c)(5)	Labor, Agricultural, and Horticultural Organizations	Educational or instructive, the purpose being to improve conditions of work, and to improve products and efficiency	1024	990 or 990EZ	No
501(c)(6)	Business Leagues, Chambers of Commerce, Real Estate Boards, Etc.	Improvement of business conditions of one or more lines of business	1024	990 or 990EZ	No
501(c)(7)	Social and Recreation Clubs	Pleasure, recreation, social activities	1024	990 or 990EZ	No
501(c)(8)	Fraternal Beneficiary Societies and Associations	Lodge providing for payment of life, sickness, accident, or other benefits to members	1024	990 or 990EZ	Yes, if certain 501(c)(3) purposes
501(c)(9)	Voluntary Employees' Beneficiary Associations	Providing for payment of life, sickness, accident or other benefits to members	1024	990 or 990EZ	No
501(c)(10)	Domestic Fraternal Societies and Associations	Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members	1024	990 or 990EZ	Yes, if certain 501(c)(3) purposes
501(c)(11)	Teachers' Retirement Fund Associations	Teachers' association for payment of retirement benefits	No Form	990 or 990EZ	No
501(c)(12)	Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Co, Etc.	Activities of a mutually beneficial nature similar to those implied by the description of class of organization	1024	990 or 990EZ	No
501(c)(13)	Cemetery Companies	Burials and incidental activities	1024	990 or 990EZ	Yes, generally

Section of Tax Code	Description of organization	General nature of activities	App Form	Annual return required	Contributions allowable
501(c)(14)	State Chartered Credit Unions, Mutual Reserve Funds	Loans to members	No Form	990 or 990EZ	No
501(c)(15)	Mutual Insurance Companies or Associations	Providing insurance to members substantially at cost	1024	990 or 990EZ	No
501(c)(16)	Cooperative Organizations to Finance Crop Operations	Financing crop operations in conjunction with activities of a marketing or purchasing association	No Form	990 or 990EZ	No
501(c)(17)	Supplemental Unemployment Benefit Trusts	Provides for payment of supplemental unemployment compensation benefits	1024	990 or 990EZ	No
501(c)(18)	Employee Funded Pension Trust (created before June 25, 1959)	Payment of benefits under a pension plan funded by employees	No Form	990 or 990EZ	No
501(c)(19)	Post or Organization of Past or Present Members of the Armed Forces	Activities implied by nature of organization	1024	990 or 990EZ	No, generally
501(c)(20)	Group Legal Services Plan Organizations	n/a	n/a	n/a	n/a
501(c)(21)	Black Lung Benefit Trusts	Funded by coal mine operators to satisfy their liability for disability or death due to black lung diseases	No Form	990-BL	No
501(c)(22)	Withdrawal Liability Payment Fund	To provide funds to meet the liability of employers withdrawing from a multi-employer pension fund	No Form	990 or 990EZ	No
501(c)(23)	Veterans Organization (before 1880)	To provide insurance and other benefits to veterans	No Form	990 or 990EZ	No, generally
501(c)(25)	Title Holding Corporations or Trusts with Multiple Parents	Holding title and paying over income from property to 35 or fewer parents or beneficiaries	1024	990 or 990EZ	No
501(c)(26)	State-Sponsored Organization Providing Health Coverage for High-Risk Individuals	Provides health care coverage to high-risk individuals	No Form	990 or 990EZ	No
501(c)(27)	State-Sponsored Workers' Compensation Reinsurance Organization	Reimburses members for losses under workers' compensation acts	No Form	990 or 990EZ	No
501(d)	Religious and Apostolic Associations	Regular business activities. Communal religious community	No Form	1065[9]	No
501(e)	Cooperative Hospital Service Orgs	Performs cooperative services for hospitals	1023	990 or 990EZ	Yes
501(f)	Cooperative Service Organizations of Operating Educational Organizations	Performs collective investment services for educational organizations	1023	990 or 990EZ	Yes
501(k)	Child Care Organization	Provides care for children	1023	990 or 990EZ	Yes
501(n)	Charitable Risk Pools	Pools certain insurance risks of 501(c)(3)	1023	990 or 990EZ	Yes
521(a)	Farmers' Cooperative Associations	Cooperative marketing and purchasing for agricultural producers	1028	990-C	No

Understanding Foundations

There are two types of 501(c)(3) organizations: publicly supported and private foundations. The word "foundation" is used in the names of many different types of organizations but has no legal meaning in and of itself. In fact, every organization recognized as tax-exempt under section 501(c)(3) is considered by the IRS to be a **private foundation** unless it meets one of the tests in the law that demonstrate it is not. Some groups that call themselves "foundations", for example, are really "501(c)(3) charitable organizations" rather than private foundations, even though they have the word "foundation" in their name. It is beneficial to demonstrate that you are a "charitable organization" if you fit that description because private foundations operate under more restrictive rules and are subject to certain taxes that do not apply to charitable organizations.

Private Foundations

A private foundation is a nonprofit, tax-exempt organization with a principle fund or endowment, usually from a single source, such as an individual, family or corporation. To be a private foundation:

- General public support cannot be a significant part of its funding,
- Programs must be managed by its own board members, and
- It must be established to maintain or aid social, educational, religious or other charitable activities serving the common welfare, primarily through grantmaking.

Private foundations are tax-exempt under Section 501(c)(3) of the Internal Revenue Code, but have greater restrictions than "charitable organizations" as defined under the code.

There are several rules that affect private foundations:

- A 2% excise tax on net investment income such as stock dividends. Excise taxes may also be applied for owing more than a certain percentage of an operating business, lobbying, and jeopardizing charitable purposes.
- Each year a private foundation must distribute a minimum amount of its "distributable" income for charitable purposes. If it does not, it must pay an excise tax. Please consult with a tax accountant or attorney for more specific details.
- Private foundations are prohibited from engaging in any lobbying activity.
- There is also significantly more paperwork and reporting involved
- Private foundations file a Form 990-PF.

Public Foundations

A public foundation refers to a nonprofit public charity 501(c)(3) that receives at least one-third of its income from the public and generally operates grants programs benefiting unrelated organizations or individuals as its primary purposes. Public foundations include community foundations, which are considered "charitable organizations" rather than private foundations, because they have many funding sources. Increasingly, public foundations have been established to receive funds and make grants for populations with special needs, for specific subject areas, or around other non-geographic communities of interest.

Reporting Changes in the Organization

Amendments to Articles or Bylaws

If there have been any key changes in your organization, especially with regards to your legal structure, you'll want to ensure your articles of incorporation are amended accordingly. You will need to fill out an amendment form and submit it to the Washington Secretary of State Corporations Division. For a sample of this form, see Appendix D, page 95.

Once you have received approval of the amendment from the Washington Secretary of State, you must notify the IRS by submitting a copy of the changes. You may do this independently, or along with your annual Form 990. Organizations that are not required to file a Form 990 should notify the IRS district director of any such change. The address for notification should appear on the organization's IRS determination letter.

Changes in Tax-exempt Status

If you realize that you have been designated the wrong tax-exempt status, or have discovered your status has changed over time, you will need to re-apply for tax-exempt status with the IRS under the new category. Before doing this, if necessary, you must amend your articles with the Washington Secretary of State, receive their approval, and then submit the approved articles with your application for tax-exempt status with
the IRS.

EXERCISE 2

Think about your own organization.
What type of tax-exempt organization is it? ____________________________

Do you think you have been filed correctly? ____________________________

Why or why not?

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What makes a 501(c)(3) different from other types of nonprofits?

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▶ **ACTION PLAN: If you think you have been filed incorrectly, add this concern to your Action Plan on pages 89-90to discuss with your board.**

Chapter 3

How do You Become a Nonprofit Organization?

Although many of you are sitting on the boards of nonprofit organizations already in place for many years, it's important to understand a bit about how organizations are incorporated so that you can ensure proper procedures have been followed and the appropriate documentation is in place.

Forming a Nonprofit Organization

An organization must first incorporate with the Washington Secretary of State Corporations division as a nonprofit. They may then apply to the IRS for federal tax-exempt status, apply to the charities division in order to solicit money in Washington State, and apply for a master business license if the organization will be doing any business or have any employees. The checklist below in Form 2 will guide you through the steps. More details about incorporating follow the checklist.

FORM 2—Checklist for Becoming a Nonprofit Organization

This is a list of the steps to take to form a Washington nonprofit corporation and a tax-exempt organization. Please use this as a guideline only as rules can change over time. It is also advisable to have a lawyer look over your materials before submitting them.

___ 1.	Determine the purpose of the organization. Form a board of directors. Choose a name for the organization and determine the names and addresses of a registered agent, the initial board of directors, and the incorporator(s) for the articles of incorporation.
___ 2.	Contact the WA Secretary of State at (360) 753-7115 or *www.secstate.wa.gov* and request the materials required to establish a nonprofit corporation. The materials will include: an articles of incorporation form and instructions; the state's nonprofit statutes, which should be reviewed carefully prior to preparing your articles of incorporation and corporate bylaws; a list of fees for filing; and instructions for post-incorporation activities.
___ 3.	Draft **articles of incorporation.** Have two copies of the articles signed by each incorporator and the registered agent. File both originally signed copies with the Secretary of State in Olympia with the filing fee by mail or in person. Filing fees are $150 if your organization has a budget of $10,000 or less or $500 if your budget is over $10,000.
___ 4.	Draft **bylaws**.
___ 5.	Hold an initial board meeting (after articles are approved): adopt bylaws; elect officers; determine banking and financial arrangements; authorize the preparation and filing of all necessary forms with the IRS to obtain 501(c)(3) status; ratify actions and expenditures of incorporators prior to incorporation. Develop a strategic plan. Develop a resource and development plan. Establish a record keeping system for the organization's official records. Establish an accounting system.
___ 6.	Acquire IRS Publication 557—"Tax Exempt Status for Your Organization," from the IRS to determine what forms you need to file for federal income tax-exemption. You can download these forms & publications directly from the IRS at *www.irs.gov*. Or you can order them over the phone at 1-800-829-3676 (allow about two weeks for delivery).
___ 7.	Complete appropriate forms for the federal government. For example, * 501(c)(3)s will complete **IRS form 1023,** (application for tax-exempt status) and **form 8718** (filing fee), and if appropriate, forms 872-C (advance ruling submissions) and 5768 (lobbying election). Submit with filing fee and exhibits to appropriate IRS office. Fees to file the first time depend on operating budget are $150 (if below $10,000) or $500 (if above $10,000).
___ 8.	Complete **IRS form SS4** (federal employee identification number—EIN), have executed by officer and fax or mail to IRS.
___ 9.	Complete and file the **Washington State Charitable Solicitation** registration form—long if required, short, if exempt. It is a $30 initial fee and $10 each year after. (Details follow).
___ 10.	Apply for **Washington Master Business License** if conducting business and hiring employees.
___ 11.	**File for state and local tax exemptions.** In accordance with state, county, and municipal law, apply for exemption from income, sales, and property taxes. Resources: State, county, or municipal department of revenue.

Articles of Incorporation & Bylaws

The articles of incorporation & bylaws constitute the organizational and governing documents of a nonprofit corporation and are what actually create the corporation under state law. When they are completed two copies must be filed with the Washington Secretary of State Corporations division along with a filing fee. The bylaws provide the rules under which the corporation operates. The articles and bylaws should not have provisions which conflict with one another. The articles are not easy to change (although it is possible), so it is important to ensure they meet the needs of your organization. The board can, however, amend the bylaws at your meetings.

- ***Note: Board Politics.*** The articles of incorporation and bylaws are the places where important items such as quorums are set. Quorums are important as they can be used politically to ensure items are held up or not voted on if there are not ample people present. It is therefore important to think through areas of potential issues and create articles and bylaws that will work best for your organization and group.

The Charitable Solicitation Act

The Washington State Charitable Solicitation Act, (RCW 19.09.010-.913), regulates all oral or written requests for charitable contributions made within Washington. An organization engaged in charitable solicitations, must register with the Secretary of State unless it qualifies for an exemption.. Qualifying exemptions are if the organization will not receive $25,000 or more in donations in a given year, if it is run entirely by volunteers with no staff at all and if it does not have a single person used for fundraising purposes. Filing fees are currently $30 the first year and $10 each additional year.

If you are registered with the Charities Division, you must maintain current financial records and records of contracts with independent fundraisers for three years (RCW 10.09.200). Penalties apply for violation of charitable solicitation laws and directors who participate in or with knowledge approve of such violations may be held personably liable. Please see Appendix B and C, pages 93 and 94 for a summary of the registration requirements of the Charitable Solicitations Act and a Sample Application.

- ***Note:*** If you qualify for an **exemption**, it is still important to file the "short" form for $20 and let the Charities Division know of your existence. This form asks for some basic organization information, but does not ask for your finances. If an individual who has been approached by your organization for a donation wants to establish the validity of your organization, having filed this form allows the Charities Division to reply that you are an existing organization and assuage the person's fears.

Master Business License Application

Another application you should be aware of is the Master Business License Application, which can be obtained from the Department of Licensing (*www.dol.gov*). Completion and filing of the Master Business Application will provide your organization with its basic state tax registration and employer registration. Basic state tax registration is required if the organization plans to engage in any business activity. The Master Business Application will also register the corporation for payment for certain state employment taxes. These include:

- Registration with the Department of Labor and Industries and establishment of an Industrial Insurance Account, and
- Registration with the Employment Security Department, for purposes of unemployment insurance (for organizations with employees)

After the MLA is completed, the employer will receive a unique "UBI" number (Unified Business Identifier number). This is the number that identifies employees to the state.

EXERCISE 3

Who in your organization is responsible for verifying these records are correct?

Who is responsible for checking in with your sponsoring agency?

Where are these records kept?

Are copies available to all board members? Have you seen these records? For what reasons?

► **ACTION PLAN: If you aren't sure of who is responsible for this work, where the records are, or if they are all there, add these items to your Action Plan on pages 89-90 to check on.**

Chapter 4

What are the Ongoing Reporting Requirements for Federal, State and Local Governments?

QUICK GLANCE
Federal: Ongoing requirements must be met in order to maintain tax-exempt status. If your organization is required, you must report and submit the following yearly or quarterly: IRS Form 990, unrelated business income tax, and employee income tax and social security.
State: In Washington State, an annual report and fee and Charities renewal and fee must be filed for most nonprofit organizations. State and local taxes also may need to be filed where relevant.

Your organization will likely have requirements that must be met each year for federal, state, and local governments. For the federal government, the IRS imposes certain restrictions and requirements on the purpose and operation of a tax-exempt organization. In exchange for exemption, an organization must ensure that its activities benefit the general public. ***Directors are responsible for seeing that these requirements are met.***

The requirements for Washington state and local governments are such to ensure that organizations update the government of changes, stay on mission, and pay relevant taxes. The chart below provides an at-a-glance summary of federal and state requirements and timelines. Details about the requirements follow. See Appendix I, page 100, for a Legal Compliance Checklist.

Form 3—Summary of Federal and State Requirements

Federal	Frequency	Timeline
Form 990, 990EZ, or 990PF	One time a year	15th day of 5th month after end of fiscal year. May 15 if Jan-Dec, Nov 15 if July-June)
Form 990-T (Tax on Unrelated Business Income)	One time a year	15th day of 5th month after end of fiscal year. May 15 if Jan-Dec, Nov 15 if July-June)
With Employees:		
Employee Income tax and FICA withheld by organization	Throughout the year	Weekly, monthly or quarterly depending on size of organization.
Federal Unemployment Taxes (FUCA)		Quarterly, only when over $100. Otherwise, once a year.
State	**Frequency**	**Timeline**
Annual Report and Fee	One time a year	Will be sent to organization each year, 45 days prior to the month and date originally incorporated.
Charities Division Renewal	One time a year	Will be sent to organization 60 days before the 15th day of 5th month after end of fiscal year. May 15 if Jan-Dec, Nov 15 if July-June).
State and Local Business Taxes	Variable-yearly	Monthly, Quarterly, Yearly, depending on type of tax and size of business.

Federal Government

IRS Form 990, 990EZ, 990PF

Filing requirement

Most tax-exempt organizations must file an annual return with the IRS. See Form 1—Tax-Exempt Organization Reference Chart, page 23 for required federal forms. For Section 501(c)(3) organizations that are charitable organizations, and most other types of tax-exempt organizations, the return is made on IRS Form 990 (*Return of Organization Exempt From Income Tax*) or Form 990-EZ (*Short Form Return of Organization Exempt From Income Tax)*. It is designed for use by small tax-exempt organizations and nonexempt charitable trusts. See Appendix E, page 96, for Form 990 first page.

An organization may file Form 990-EZ if (1) its gross receipts during the year were less than $100,000, and (2) its total assets at the end of the year were less than $250,000. Form 990-EZ is the form used by the majority of nonprofit organizations that have to the report to the IRS. See Appendix F, page 97 for sample first page.

All private foundations exempt under 501(c)(3) must file Form 990-PF, *Return of Private Foundation*. See Appendix G, page 98 for sample first page.

Exceptions

Tax-exempt organizations (other than private foundations) that do not normally receive more than $25,000 in gross receipts each year **are not required** to file an information return. This is the case for many nonprofits. However, it should be noted that even though an organization may not be required to file a return**, it is recommended that it do so anyway** because, as a public document, it allows greater openness to the public.

Filing date

The return must be filed on or before the 15th day of the fifth month following the close of an organization's annual tax accounting period (i.e., May 15, for a calendar-year organization).

Treatment as a public relations document

Form 990 returns are public documents. A Section 501(c)(3) organization must disclose to the public its Form 990 returns for the three most recent tax years. This is how many funders and individual learn about organizations these days. The website, Charity Navigator, at *www.charitynavigator.org*, for example, has easily accessible public information from 990 reports from nonprofits all over the country. Accordingly, a tax-exempt organization should consider the information in its Form 990 return to be a public relations tool and should treat the preparation process as an opportunity to advertise the organization's programs and good works to the public.

Penalties

If an organization fails to file a Form 990 in a timely manner or to provide a copy of the return upon request, they may have to pay penalties of $10-$20 per day, with a cap of the lesser of $10,000 or 5% of the organization's gross receipts for the year. For large organizations (gross receipts exceeding $1 million for any year), the penalty is $100 per day, with a cap of $50,000. The penalty may be abated if reasonable cause can be shown.

The Most Frequently Found Errors On The Form 990

Below are things to watch out for on your own Form 990. They are the five most frequently encountered errors discovered by the Washington State Charities Program while reviewing the IRS Form 990:

1. Not reporting revenue and expenses resulting from the use of a commercial fundraiser or commercial coventurer (paid solicitor)
2. Reporting net instead of gross revenue from special events and other fundraising activities
3. Mathematical errors (e.g. not carrying totals over from columns to line items on page one, columns not adding up properly)
4. Not reporting funds expended for program services
5. Missing pages or attachments

Form 990-T: Organizations With Unrelated Business Income Tax

Even though an organization is recognized as tax-exempt, it still may be liable for tax on any income it brings in that's not directly related to its mission, known as "unrelated business income". The activity must be conducted as a *trade or business*, be *regularly carried* on, and *not substantially related* to the exempt mission of nonprofit. For example, if a hospital was to operate a coffee shop the income received would be taxable even if it was used to support their nonprofit mission. There are some activities that the IRS has ruled will not be subject to the unrelated business income tax and organizations should look into these before filing. An exempt organization that has **$1,000 or more gross income** from an unrelated business must file Form 990-T, *Exempt Organization Business Income Tax Return* in addition to the obligation to file the annual information return. Tax-exempt organizations must make quarterly payments of estimated tax on unrelated business income if it expects its tax for the year to be $500 or more. Penalties apply for late filing, late payment or underpayments of taxes on income reportable on Form 990-T.

Requirements for Organizations with Employees: *Federal Income Tax, Social Security, Unemployment Tax, and Employee Tax Returns*

Every employer, including a tax-exempt organization, who pays wages to employees is responsible for withholding, depositing, paying, and reporting federal income tax, social security taxes (FICA), and federal unemployment tax (FUTA) for such wage payments, unless that employer is specifically excepted by statute from such requirements or if the taxes are clearly inapplicable. These reports and payments are made on a weekly, monthly or quarterly basis depending upon the size of your organization. Tax-exempt organizations are also required to prepare and file annually certain employee tax return forms for purposes of reporting amounts paid to employees and others, in the same manner as for-profit organizations. These include Forms W-2 and 1099. When you hire, you will need employees to fill out Form W-9, which is a request for their taxpayer identification number, so that you can accurately prepare these other forms later when needed.

Maintaining Tax-exempt Status

When an organization receives its tax-exempt status, it is the beginning, not the end of a compliance process that will continue throughout the corporation's life. An organization must continue to comply at all times with the tax law requirements in order to maintain its exemption. Specifically[2]:

- The organization must be organized and operated at all times exclusively to further charitable purposes;
- It must not allow any of its assets to "inure" to the benefit of an "insider";
- It must not participate in any campaign for political office;
- It must not engage in attempts to influence legislation as any substantial part of its activities;
- It must report and pay tax on any unrelated business income; and
- It must comply with a variety of annual reporting and public disclosure requirements.

It's crucial for a board member of a nonprofit organization to understand the purpose of the organization's tax exemption and what types of activities would threaten it. The tax exemption itself is often the organization's greatest asset, and losing it can be devastating.

Intermediate Sanctions

Until the passage of Intermediate Sanctions law in 1996, the IRS's only recourse when faced with abuses such as insiders benefiting from unfair and excessive economic advantages was to punish the organization by revoking their tax-exempt status. Though it was unfair to the innocent beneficiaries of the nonprofit's goals, the IRS was powerless to punish individuals. Now the IRS has recourse. Individuals participating in "excess benefit transactions" are held personally responsible for severe penalties in the form of excise tax.

[2] Excerpts from *How to Form and Maintain a Nonprofit Corporation in Washington State,* published by King County Bar Association, Young Lawyers Division, Community Involvement Committee

State and Local Governments

In addition to the requirements that must be fulfilled for the federal government, there are some state and local requirements your organization will likely be subjected to as well.

Annual Report & Fee

Each year, 45 days before the anniversary of an organization's incorporation date, the Washington Secretary of State sends an annual form to every 501(c)(3) nonprofit corporation. The corporation must return the report with the required fee (currently $10) to the Secretary of State by the due date to preserve its corporate status. The report requests a list of the corporation's officers and directors, any change to the address of the corporation's registered office or agent and other basic information.

A corporation's failure to file the report within 45 days can result in *automatic dissolution of the corporation by the Secretary of State*. The organization is sent a certificate of dissolution in the mail. They then have the option to reinstate this status within 3 years. If they decide to do so, they must call up the Secretary of State, obtain and submit the appropriate forms, and pay a fee of $45-$75, depending on how long the organization waits. If an organization is inactive with the Washington Secretary of State, their tax-exempt status becomes in jeopardy.

If you are not a 501(c)(3), you should verify with the Secretary of State that you do need to file this.

State and Local Taxes

In Washington, nonprofit organizations are presumed taxable in the same manner as for-profit organizations. Therefore, if no statutory exemption or deduction exists, a nonprofit organization must pay, to the extent applicable, each of the following taxes: (i) State and local business and occupation taxes, (ii) State and local sales taxes, (iii) State and local use taxes and (iv) Real and personal property taxes and (v) Real estate excise taxes. ***Your organization should consult with your attorney, tax accountant or contact the Washington State Department of Revenue at 1-800-647-7706 for details on which taxes will apply to your organization and when they must be filed, or how to file for an exemption.***

- ***(i) Business and occupation tax***

  Washington imposes a business and occupation tax ("the B&O tax") based on the gross receipts of ***every entity engaged in business activities in the state***. Thus, a nonprofit organization engaged in business activities must pay the B&O tax based the value of its products, the gross proceeds of its sales, or the gross income of its business, as appropriate. Income from endowment funds is exempt from B&O tax liability. Grants received by nonprofit organizations **may be** deductible from the B&O tax under the bona-fide contribution and donation exemption. You should clarify the tax treatment for any grants you might receive with an accountant.

  State law permits **cities** to also impose a local business and occupation tax, which is tied to the state tax. Over thirty-five (35) Washington cities assess such a tax, including Seattle, Tacoma, Bellevue, Bellingham, Everett and Olympia. Each city administers its business and occupation tax independently. ***Contact the Washington Department of Revenue for details on how these taxes will apply to your organization at 1-800-647-7706, or consult your tax attorney or accountant.***

(ii) *Sales tax*

Washington imposes a tax upon the sale of any article of tangible personal property to consumers. Therefore, unless an exemption applies, nonprofit organizations should collect the sales tax on all sales of tangible personal property. ***Some exemptions apply***. These are: sales to the Red Cross; sales of food products for human consumption (not immediate consumption on the premises), sales to artistic or cultural organization of certain items for exhibition or presentation, sales of amusement or recreational services and physical fitness services provided by nonprofit youth organizations, and certain fundraising activities.

(iii) *Use tax*

Washington imposes a tax on the user of any article of tangible personal property acquired by purchase or gift where the user or donor has not paid the retail sales tax. The use tax does not apply to donations of tangible personal property used by a "nonprofit charitable organization."

(iv) *Personal and real property tax*

Washington exempts qualifying nonprofit organizations from the payment of:
Real property taxes; Personal property taxes; and Leasehold excise taxes. This is a twelve and eighty-four one hundredths percent (12.84%) tax on leasehold interests in publicly owned real or personal property. The tax base is measured by the amount paid for the use of the property. If a nonprofit organization receives the use of donated property, the tax base is the fair market value of the rents on similar property. Exemptions are only allowed for specific types of activities. ***Some exemptions apply***. See Appendix H, page 99, for complete list of types of property qualifying for exemption.

(v) *Real estate excise tax*

Washington imposes a transfer tax on the sale of real property including leasehold improvements and those involving a fifty-percent (50%) or more controlling interest in any entity that owns the real property. Nonprofit organizations, even if exempt from real or personal property taxes, are nevertheless subject to the real estate excise tax unless the transaction is otherwise specifically exempt.

EXERCISE 4

Who in your organization is responsible for preparing these reports to the federal, state and local governments?

Do you know whether your organization is in full compliance and submits the required reports on a regular basis?

How can you find out?

ACTION PLAN: If you aren't sure if your organization is in compliance, or are interested in checking to be sure, add this to your Action Plan on pages 89-90.

Part III

Accountability and Liability

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Part III
A Director's Role In Organizational Accountability and Liability

SCENARIO 3

You sit on the board of directors for a 501(c)(3) organization, whose purpose is to be the fundraising arm for another organization, Youth Power, which funds various youth programs and activities. As it does twice a year, your organization recently gave several thousand dollars in funding to Youth Power to be used for accomplishing the organization's mission. The funding was not specifically designated for certain programs and Youth Power had discretion over how to use the funds. They decided to use part of the funds to pay for a group of young women to go to summer camp.

At the camp, one of the youths was in an accident and became injured. As a result of this incident, the family has decided to sue not only the camp, but also Youth Power, and your organization as well.

Though you've recently obtained it, your organization did not have directors and officers liability insurance when you were named on the lawsuit. As a result, you and the rest of your board are really nervous. Are you liable for these actions?

PERSONAL LIABILITY CAN BE A SCARY ISSUE IF YOU'RE UNSURE WHAT THE RULES ARE. Fortunately, if you're doing your job, and following the rules, there is little to fear. This section takes you through what the best ways are for your organization to be open and accountable, thus preparing the way for proper organizational and director conduct. Accountability is the first step in insuring that you as a director have no reason to be afraid that something could blow up and surprise you. This section then addresses the various forms of liability that you could be subjected to over time, as well as the ways in which you can protect the organization and yourself.

Chapter 5

What Does it Mean to be Accountable?

You are the link between your nonprofit organization and the public or membership that supports it and is served by it. That public is increasingly holding board members legally and ethically accountable for the actions or inactions of organizations. It's up to you and your fellow directors to ensure they have the information they need to know your organization is on the right track. To be accountable to its constituency, as well as to maintain tax-exempt and corporate status with federal and state agencies, your nonprofit organization must maintain accurate and current financial records. Failure to maintain such records increases the likelihood of unauthorized removal of funds, may jeopardize the nonprofit organization's tax-exempt status, and may leave directors open to accusations regarding financial mismanagement.

Ways to Become a More Accountable Organization

What are the board's responsibilities?

To become a more accountable organization, your board should:

- Make your IRS Form 990s easily available (and for companies under $25,000, submit a 990EZ even though you're not required).
- Publish an annual report with financial data.
- Rely on annual independent audits.
- Create necessary policies and enforce them regularly.
- Avoid and manage conflicts of interest.
- Understand your board's role and responsibilities.
- Be familiar with intermediate sanctions.
- Keep good records and keep them organized.
- Know the federal regulations and your state laws.

The Board and Finances

A large part of accountability is the fiduciary duty you and the other board members have. Your board has the primary responsibility for making sure that the organization 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. The board should be involved and informed in all aspects of the finances of the organization.

What are the board's responsibilities?

To practice their fiduciary duty, your board should[3]*:*

- Make sure that a realistic annual budget is developed.
- Develop the budget early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year.

[3] List derived from "A Guide for Board Members of Nonprofit Organizations, United Way of the Capital Area

- ♦ Ensure that the organization has adequate internal accounting systems.
- ♦ Expect management and/or committee members 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. Board meetings should provide an opportunity to review these documents.
- ♦ Require periodic confirmation from those responsible that all required filings (such as tax returns) are up-to-date and that employee withholding taxes and insurance premiums are being paid when due.
- ♦ Consider the value of maintaining standing audit and finance committees.
- ♦ Insist that fundraising is done honestly and with integrity. Fundraising projections should be carefully monitored to assure they are realistic. 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 and does not put the organization at risk.
- ♦ Confirm that any restricted gift to the organization is separately accounted for, and that the funds are being used in accordance with the terms of the restriction.

Keeping Responsible Records

The Corporate Record Book

Your nonprofit organization should keep a corporate record book of all its organizational documents. These documents include the articles, bylaws, any amendments to the articles or bylaws, minutes of all board and committee meetings, waiver of notice or notice of all meetings, tax exemption application and determination letters, annual reports, membership certificates, all insurance policies, warranties, contracts, leases and other legal documents, and copies of all communications with board members, officers, members and contributors. Corporate records should be kept at the principal office of the corporation.

Public Documents

Certain corporate documents are part of the public record. In Washington, the Corporations Division of the Secretary of State keeps all public corporate records in Olympia. The public corporate documents include the articles of incorporation and any amendments, articles of merger or consolidation, articles of dissolution, the name and address of the corporation's registered office and registered agent, the corporate annual report forms which disclose the names and addresses of the corporation's directors and officers, and certain other information such as the Unified Business Identifier (UBI), the license expiration date, the type of corporation (nonprofit), and, with respect to corporations and those incorporated in other states which are qualified to do business in Washington, their state of incorporation.

Minutes

Minutes should be recorded after every meeting and distributed to each board member with one copy filed in a central location. Although minutes do not have to be made available to everyone in an organization, they must be made available for government audits. It is wise to consider them as public documents. Use good judgment in what to record in the meeting minutes, as you don't want "sloppy talk" to become a part of the permanent record. Ensure that all decisions and votes are recorded, as well as who voted for each item. Minutes serve as the organization's institutional memory and it is good to capture intention as well as formal motions. It is also good to have enough information so that a review of the meeting notes from the last meeting can put your next one a step further.

While content can vary, based on your individual organization, the basic elements of good minutes include:

- Name of the organization
- Date and time of meeting
- Board members in attendance, excused, and absent
- Existence of a quorum
- Voting results
- Names of abstainers, supporters and dissenters
- Reports and documents introduced
- Future action steps
- Time meeting ends
- Signature of secretary and chair

Some boards also include motions made and by whom and a brief account of any debate. Your board should determine how much detail is desirable without cluttering the document with irrelevant data. Committees and subcommittees should follow the same protocol as when the full board meets.

Record Keeping Requirements

Nonprofits must keep accurate financial books and records, including those mentioned above and maintain them at their main place of business. The general rule of thumb is to retain records ***at least three years*** after the end of the year to which they relate. This is for receipts, bank statements, minute, etc. Keep Federal and State tax documents, however, ***from six years*** to indefinitely.

In addition, you must keep a record of all contributors who paid or donated more than $25. The donor records and other books and records must be made available to the Attorney General upon request.

Employee Records

Under Washington law, if your organization employs people, you must keep and preserve certain payroll and other records for all employees. These required records are the employee's name, address, and occupation, rate of pay, and amount paid each pay period to each such employee, the hours worked each day and each workweek by such employee. In addition to these records, employers must kept additional records for employees subject to State minimum wage and overtime laws. Such records must be kept for a period of ***at least four years***.

Disposal

You should also have a policy for safely disposing of records. You may dispose of records in any way you see fit, such as shredding. However, law *"requires entities to take reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal"*. This applies primarily for sensitive employee information.

EXERCISE 5

Rate your organization's performance as "S" Satisfactory or "U" Unsatisfactory for each of the "accountable" actions listed below.

S/U Does your organization:

_____ Make your IRS Form 990s easily available (and for companies under $25,000, submit a 990EZ even though not required.)

_____ Publish an annual report with financial data.

_____ Rely on annual independent audits.

_____ Create necessary policies and enforce them regularly.

_____ Avoid and manage conflicts of interest.

_____ Understand your board's role and responsibilities.

_____ Be familiar with IRS intermediate sanctions.

_____ Keep good records and keep them organized.

_____ Know the federal regulations and your state laws.

What can your board do to turn any of those you marked "U" into an "S"?

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ACTION PLAN: Write the actions your board can do on your Action Plan on pages 89-90.

Chapter 6

What Should Board Members Know about the New Federal Accountability Requirements?

In recent years, major corporate scandals have resulted both in eroded public trust and federal government intervention. This section describes the recent Sarbanes-Oxley Act that the federal government passed to ensure organizations are more accountable to the public. It is relevant to you as a board member because there are new regulations that directly affect nonprofits, as well as actions around accountability that your board should consider taking.

The Sarbanes-Oxley Act

In July 2002, the American Competitiveness and Corporate Accountability Act, commonly known as the Sarbanes-Oxley Act, was signed into law in order to improve the quality and transparency of financial reporting and increase corporate responsibility. This Act primarily does the following:

- Regulates what public company boards must do to ensure that auditors are independent from their clients.
- Creates the Public Company Accounting Oversight Board, which enforces standards for public company audits.
- Explains processes for electing audit committee members and for ensuring that adequate reporting procedures are in place.
- Calls for regulations, and closes most of the loopholes, in for-profit ***and*** nonprofit organizations, relating to **document destruction** and **whistle-blower protection**.

It is this last bullet that directly impacts nonprofits and could result in sanctions for your organization if not followed.

Although the main purpose of Sarbanes-Oxley is to rebuild public trust in private corporations, nonprofit organizations should be prepared for the implications of this Act as well. The recent rash of corporate scandals has made the public much more conscientious about public accountability, which indicates that ***there may be more regulations for nonprofits on the horizon***. It would be prudent for your board to voluntarily adopt some of this bill's provisions, not only in preparation for what could come, but as a means of being as open as possible and, as a result, garnering trust and support for your organization from the public and future funders. In fact, as time passes, funders are likely to start asking nonprofits to comply with Sarbanes-Oxley as a means of providing them with some security. It also provides you, the dedicated board member, with a measure of confidence that you are fulfilling your legal duties to the organization.

BoardSource, a leading resource for board members of nonprofit organizations worldwide, has developed a list of recommendations for how the key provisions of Sarbanes-Oxley might realistically be applied and adopted by nonprofits. Though many nonprofits are generally small, there are pieces of each of these recommendations that you should consider. **Special notice should be paid to Provisions 6 and 7**, as they are the two referred to above that directly impact nonprofits.

Recommendations for your board

- **1. Create a separate audit committee**. This provides needed checks and balances for every nonprofit that has an annual audit. This committee should be separate from and independent of the board's Finance Committee and provide oversight of the auditors. The Board Treasurer should serve **either** on the Finance Committee **or** the Audit Committee, but not on both simultaneously. Audit committee members must have the financial competency to understand financial statements. Smaller nonprofits that don't have an outside audit should either have a "review" or at least have their financial statements prepared by a professional accountant.

- **2. Rotate auditors.** At least the lead and reviewing partners doing your audit should be rotated every five years. Your board should use caution when contracting with auditors for non-auditing services other than tax preparation, (which should be approved prior to your audit), as this may be a conflict of interest.

- **3. Develop conflict of interest policies.** Develop a policy that prohibits the organization from providing loans to board members or executives. Your board should have a conflict of interest policy that requires disclosure and this policy must be enforced.

- **4. Improve accuracy, timeliness and completeness of disclosure on all Form 990s.** Nonprofits are already required to make their Form 990 freely available to anyone who requests one. However, the accuracy, timeliness and completeness of disclosure on all Form 990s should be improved where necessary, and all board members should review both their audited financial statements and Form 990 annually.

- **5. Ensure CEO and CFO understand all financial statements and Form 990.** Whether or not nonprofit CEOs and CFOs actually sign off on financial statements, they must fully understand them and make sure they are accurate and complete. Both should also review the Form 990 to ensure that it is accurate, complete and filed on time. If an organization does not have these positions, the Board Chair, and the Treasurer or the Chair of the Finance committee should play this role.

- *__6. Have a written document retention and destruction policy.__ All organizations should have a written, mandatory document retention and periodic destruction policy, and it should include guidelines for dealing with electronic files and voicemail. It should also cover back-up procedures, archiving of documents and regular system reliability check-ups.

- *__7. Develop and adopt procedures for handling employee complaints.__ Nonprofits must develop and adopt procedures for handling employee complaints (regarding any type of inappropriate financial management practices) and for preventing retaliation against whistle-blowers. See Appendix J, page 102, for Sample Whistle Blower Policy.

* Provisions 6 and 7 are subject to criminal penalties for non-compliance by all types of organizations, including nonprofits, so it is essential that you address at least these two in your organization's policies and practices. If your organization chooses to add to its policies in response to the Sarbanes-Oxley Act, a member of the Board should review the Act itself for more details. Visit *www.sarbanes-oxley.com* for the complete information on the Sarbanes-Oxley Act.

EXERCISE 6

How does the Sarbanes-Oxley Act impact your organization? Which rules apply to your nonprofit?

What items, if any, might your board want to consider adopting?

ACTION PLAN: If this is an item for discussion with your board, add it to your Action Plan on page 89. If there are specific actions you know your board must take, write what those are under board actions on page 90.

Chapter 7

What Role Should Audits Play?

The audit is an indispensable instrument for assuring financial accuracy and honesty, especially in larger organizations, and many funders now require a yearly audit of the organization's record keeping. The purpose of the audit is to ensure that you use generally accepted accounting methods; that you comply with laws and regulations; that you are providing reliable financial information; and that generally your organization is operating efficiently. Even in organizations with small budgets it can be an invaluable check in to ensure everything is on track. Audits are a significant step towards being highly visible to the public.

Internal Audits

It's not always practical for a small organizationto have an independent, external audit. In this case, an internal audit done by a team who does not usually have access to the books, can assure that proper policies are in place to segregate financial duties, protect cash receipts, ensure an efficient bidding process, produce timely reports, and maintain accurate records. Appropriate internal controls create a firm base for an effective outside financial audit, should the need arise.

External Audits

External audits are often required by funders, and are something every organization, no matter how small, should consider doing on a periodic basis.

Ten questions you should ask your auditor[4]

1. What internal controls are in place to prevent an employee, officer, or outside agent from intercepting checks intended for our organization prior to their being recorded on our books?
2. What controls are in place to prevent the unauthorized disbursement of funds from our bank accounts (general and payroll) by an employee or officer?
3. What controls are in place to prevent one of our vendors from over billing our organization?
4. Are you aware of any forms of compensation or benefits received by our organization's officers, directors, or key employees that were not specifically approved by the board of directors?
5. Are you aware of any inappropriate or undisclosed relationships between officers, directors, key employees, vendors, or donors?
6. Are you aware of any relationships with vendors or contractors that appear to be less than ethical, warranting further inspection, or should otherwise be considered when putting out for competitive bid, (i.e., relationships that have become too casual or close)?
7. Are there any individuals involved in the accounting process who wield excessive control or whose work is not subject to adequate review by another individual?
8. How would you characterize the morale, work environment, and professionalism of accounting personnel and senior management of our organization?
9. How would you rate our organization in terms of how well we are protected against fraud?
10. What is the most important step we could take to further protect our organization against fraud?

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[4] This list is derived from 'Protect Your Organization Against Fraud: Ten Questions You Should Ask Your Auditor' by Gerald Zack, published by BoardSource.

EXERCISE 7

Has your organization ever had an external or internal audit? What did the auditors find?

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Did your organization change any internal financial practices as a result? If so, which ones?

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▶ **ACTION PLAN: If your organization has not had an internal or external audit and has not discussed the possibility, add this to your Action Plan on pages 89-90 as an item to discuss with your board.**

Chapter 8

What Internal Financial Controls Should Be Set Up?

Nonprofits receive funds through public and private grants, dues, mailings, user fees, training programs, auctions, raffles, and a variety of other ways. Safeguarding the collection of these funds can be a difficult task. In addition, expenditures must be properly accounted for, to ensure that money is spent in appropriate ways. An effective internal control system helps ensure that all receipts are received by the organization and all cash leaves the organization properly accounted for, and it lessens the opportunity for both dishonesty and honest mistakes.

Strong internal control systems may be especially challenging to implement in many organizations due to the longevity of past practices and the keen sense of trust that underlies much of what is done. It may seem to some directors that it doesn't feel right, or that it unnecessarily complicates things to put some of these controls in place. However, it's critical in this changing climate of scrutiny that some controls are there to protect yourself and the organization. It is wise to seek to balance your internal accounting control in such a way as to ensure public confidence and maintain the integrity of your financial systems and assets, without unduly inhibiting your ability to get on with your work.

An important part of any internal control system is a well-designed set of policies that protect your organization's assets, limit your liabilities, and curtail abuse of personal expenditures.

The board should create policies that address:

- Segregation of financial duties
- Who can authorize disbursements
- Managing restricted funds
- Check signing
- Independent contractors

In addition, ensure that you and your fellow board members, particularly the audit committee, are aware of potential areas where fraud or mistakes are likely to happen.

HOW IS FRAUD DETECTED?	
During a CPA audit	2%
During an internal audit	18%
Whistle-blowers	30%
Sheer accident	50%

Not-For Profit Accounting, McMillian, 2003

Types of Internal Controls

Segregation of Financial Duties

Segregation of duties means that no financial transaction is handled by only one person from beginning to end. For cash disbursements in larger organizations, this might mean that different people authorize payments, sign checks, record payments in the books, and reconcile the bank statements. In small nonprofits managed mostly by volunteers, however, this principle can be hard to put into practice. These organizations might consider having one person, such as the board president, sign checks and assign a different person, such as the board treasurer, review disbursements, bank statements, and canceled checks on a monthly basis.

Authorization and Processing of Disbursements

You will want to develop policies regarding who in your organization can authorize payments. In larger organizations, once the board approves the budget, it does not generally need to authorize individual purchases within that budget. However, unbudgeted purchases would require additional approval. In small organizations, the board treasurer or board president may be also be asked to authorize all purchases for extra security. It is important to agree and formally define what requires board approval, and what the board treasurer and president's roles are, and to then put these policies in writing.

All disbursements should be accompanied by adequate documentation, in the form of receipts or an invoice. Cash withdrawals should ***never*** be made via ATM cards.

Check Signing

There is some debate regarding the number of signatures required on a check. In many cases, it is useful to require two signatures on checks, especially for purchases over a certain amount. This amount will vary with the organization's budget; your accountant may be able to help you determine how much is significant. Even though checks require two signatures, three or four people might have check signing authority to ensure that two signers are available to make disbursements. The number of authorized signers should be kept to a minimum, while ensuring that daily business is not unnecessarily hampered. Even though not all banks are diligent about checking the two signatures, the purpose of this internal control is to make sure that there are deliberate decisions made about whom to pay, how much to pay, and when to pay bills internally. ***You should never have your signatories pre-sign checks***.

Managing Restricted Funds

Restricted contributions are a form of revenue unique to the nonprofit sector and your organization may or may not have experienced these. Money, which has been restricted by the donor for a specific use (such as building an endowment or supporting a special project) should only be used for the purpose for which it has been given. However, many nonprofits find themselves tempted to borrow against restricted monies when facing a cash shortage. Restricted and unrestricted funds are often mingled in accounts, and restricted funds are used to meet cash needs when unrestricted funds are not available. In cases where the funder clearly prohibits such borrowing, such action violates the funder's trust and instructions and may lead to revocation of the grant. In other cases, donors allow temporary borrowing as long as the money is replaced within a certain period of time, usually within the grant year.

Ultimately, it is the role of the board to ensure that the organization fulfills its obligations to donors. Therefore, in cases where borrowing against restricted funds is permitted, the board should establish policies, which describe the circumstances under which such borrowing is allowed. These policies might include how often borrowing may occur, who may authorize the inter-fund loan, and how much can be borrowed (such as a percentage of the total grant). In addition, a repayment plan should be established and the board should be advised regularly on the status of any inter-fund loans.

FORM 4—Internal Accounting Controls Checklist

Internal Accounting Controls Checklist

The following questions reflect common internal accounting controls related to paying bills. You may wish to use this list to review your own internal accounting controls and determine which areas require further action.

___ Are all disbursements, except those from petty cash, made by pre-numbered checks?
___ Are voided checks preserved and filed after appropriate mutilation?
___ Is there a written prohibition against drawing checks payable to Cash?
___ Is there a written prohibition against signing checks in advance?
___ Is a cash disbursement voucher prepared for each invoice or request for reimbursement that details the date of check, check number, payee, amount of check, description of expense account (and restricted fund) to be charged, authorization signature, and accompanying receipts?
___ Do authorized persons approve all expenditures in advance?
___ Are signed checks mailed promptly?
___ Does the check signer review the cash disbursement voucher for the proper approved authorization and supporting documentation of expenses?
___ Are invoices marked Paid with the date and amount of the check?
___ Are requests for reimbursement and other invoices checked for mathematical accuracy and reasonableness before approval?
___ Is a cash disbursement journal prepared monthly that details the date of check, check number, payee, amount of check, and columnar description of expense account (and restricted fund) to be charged?
___ Is check-signing authority vested in persons at appropriately high levels in the organization?
___ Is the number of authorized signatures limited to the minimum practical number?
___ Do larger checks require two signatures?
___ Are bank statements and canceled checks received and reconciled by a person independent of the authorization and check signing function?
___ Are unpaid invoices maintained in an unpaid invoice file?
___ Is a list of unpaid invoices regularly prepared and periodically reviewed?
___ Are invoices from unfamiliar or unusual vendors reviewed and approved for payment by authorized personnel who are independent of the invoice processing function?
___ If the organization keeps an accounts payable register, are payments promptly recorded in the register to avoid double payment?
___ If purchase orders are used, are all purchase transactions used with pre-numbered purchase orders?
___ Are advance payments to vendors recorded as receivables and controlled in a manner that assures that they will be offset against invoices or expense vouchers?
___ Are board members required to submit expense reports for all travel related expenses on a timely basis?

From the Price Waterhouse's booklet—
Effective Internal Accounting Control for Nonprofit Organizations: A Guide for Directors and Management

ACTION PLAN: Review the list above. If you want to check on any of these items with your board, add this to your Action Plan on pages 89-90.

A Note on Independent Contractors

It is a common practice for organizations to hire independent contractors for distinct or part-time services. For small nonprofits with little or no staff, independent contractors often become the primary way of doing business as it relieves the organization of the necessity of paying taxes and benefits. However, often it has become a means for "hiring" personnel who are employees in act, but not in fact. In the past, employers were generally not penalized for improper classification, but this has changed as the loss of payroll tax income to the government has become much larger. The IRS is now more diligently enforcing compliance with rules and regulations on the proper classification.

If you have contractors working for your organization that you suspect may actually qualify as employees, see Appendix P, page 109, which lists a criterion of 20 questions from the IRS to help you decide. If after working through the form, a genuine question exists, it is better to opt for employee status because monetary ***punishment for noncompliance can be severe.*** Employers out of compliance will be assessed the full employer's share of Social Security and Medicare on the total payments, plus penalties and interest. In addition, independent contractors sometimes take legal action against the employer and recover damages such as vacation leave, health benefits, and pension contribution.

EXERCISE 8

Your organization owes you $280 from some supply expenses for a past event. How would the organization go about issuing you a reimbursement check?

Can you identify any funds within the organization, which cannot be used for general purposes, but can only be used for special projects? What are they designated for?

Chapter 9

What Liability Issues Might You and Your Organization Face?

Types of Liability

Nonprofit board members often worry about being sued. It's one thing for you to volunteer your time and energy to an organization you believe in and quite another to risk unlimited personal liability if something goes wrong. Although relatively few nonprofit board members have actually been sued for their conduct as board members—and far fewer have ultimately been found liable for damages—this concern about potential personal liability is real and pervasive. There are two types of liability you need to be aware of.

Unrelated Third Parties

▶ **First** is what's known as the *potential liability to unrelated third parties for injury or property damage arising from their acts or omissions on behalf of the organization.* This type of liability is substantially the same as you face in your daily activities, where you can be sued for negligent driving that causes an auto accident, or water on the floor that causes a guest to slip and fall during a birthday party.

For example, a board member of a homeless shelter would not ordinarily be personally liable if a client was hurt in a car accident while being driven from the clinic to the shelter. However, if the board had specifically decided to fund the rides knowing that the drivers had poor driving records, they might be. (Another reason to be diligent about your minutes.) Although normally an individual is not personally liable for improper conduct of the organization itself or other employees, every individual ***is*** responsible for his or her own actions.

Written Policies to help avoid liability issues

- ▶ Conflict of Interest
- ▶ Executive Compensation
- ▶ Employment
- ▶ Termination
- ▶ Endowment Policies
- ▶ Gift Acceptance Policies

Fiduciary Duty

▶ **Second** is the *potential for liability to the organization and its members for failing to fulfill their "fiduciary" duties.* These include the duties mentioned in Section I: the duty of loyalty, to avoid putting your own interests ahead of the interests of the organization and the duty of care, to exercise good faith and reasonable judgment in making business decisions. Some examples of what types of actions might violate fiduciary duty include:

- ♦ Failure to pay taxes. The most critical area in which a nonprofit board member can legitimately lose sleep at night is the organization's failure to pay federal, and sometimes state, payroll withholding taxes. A person "responsible" for those payments may be personally liable if they are not made.
- ♦ A board member, who gets an unreasonable and undisclosed fee on a business transaction with the corporation, would violate duty of loyalty.
- ♦ Allowing large amounts of cash to be left for long periods in non- interest-bearing checking accounts, rather than being invested for the benefit of the organization, might violate duty of care.

Liability Protection

Organizations that want to keep board members take pains to ensure that board members' potential exposure is reduced. Changes in state and federal laws in the last decade and an increasing sophistication in purchasing directors and officers' liability insurance have given nonprofits a greater ability to provide protection for their board members and their organizations, although it can get expensive.

But the ultimate responsibility lies with the board members themselves—to do the duties they've committed to in good faith and with due diligence.

Indemnification

Most nonprofit bylaws include indemnification provisions—language that expresses the intent of the nonprofit to cover the expenses a board member might incur in defending an action and paying settlements or judgments related to his service on the board. There are circumstances, however, when indemnification is not available or becomes a hollow promise. These include:

- When the nonprofit does not have sufficient resources to pay the losses and expenses incurred by a director or officer;
- When state or federal law limits the protection that may be afforded through indemnification due to public policy considerations;
- When the board is unsympathetic to the plight of the director who has been sued and refuses to authorize the indemnification;
- When the organization decides that it is inappropriate to use the nonprofit's financial resources to indemnify a director.

Volunteer Protection

Every state has a volunteer protection law and the federal Volunteer Protection Act (VPA) became the law in September 1997. The Volunteer Protection Act provides that, if a volunteer meets certain criteria, he or she shall not be liable for simple negligence while acting on behalf of a nonprofit or governmental organization. The VPA also provides some limitations on the assessment of non-economic losses and punitive damages against a volunteer. This means that most nonprofit directors have a fair amount of protection. The Volunteer Protection Act does not, however, protect a volunteer from liability for harm *"caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer action."* The Act does not prohibit lawsuits against volunteers nor does it provide any protection for nonprofits. Washington State law extends protection to all volunteers of an organization, not just directors. (RCW 4.24.670)

Insurance

Every nonprofit must consider how it will pay for injuries, damages, legal expenses and other costs that stem from the harm it causes[5]. For some organizations, reserve funds are sufficient to pay for anticipated losses. For the majority of the nation's 1.5 million nonprofits, reserves are inadequate.

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[5] The information in this section is derived from The Management Library, written by The Management Assistance Program for Nonprofits

For this reason, a growing number of nonprofits choose to purchase insurance and pay an annual premium in exchange for the promise that funds will be available in the event a covered loss occurs.

General liability insurance & non-owned auto coverage

So, the question is: can you insure against your liabilities? The answer is typically Yes—and No. Every organization, particularly if it owns or rents a physical space, should have general liability insurance. This covers you if, for example, visitors fall down they stairs. It would be appropriate to add board members and any staff as additional insured under this coverage. The organization may also considering purchasing Non-Owned Auto Coverage, which protects the organization when an employee is driving a family car for business reasons and also covers rental cars. This coverage is often contained in the general liability policy if your organization has this type of coverage, but this should be verified.

D&O and fidelity coverage

The most difficult area to review is directors and officers' insurance, or D&O, which is also connected with fidelity coverage. Organizations moving large amounts of money should have fidelity coverage to cover possible criminal acts, which are specifically excluded from D&O. Areas under fidelity include theft, robbery, burglary, forgery and general mischief involving computers. D&O, on the other hand, may protect the board from failure to implement proper controls that would have prevented the losses from the exposures covered under fidelity. BoardSource's booklet "Nonprofit Board's Role in Risk Management" notes that D&O insurance does not cover: fines and penalties imposed by law, libel and slander, personal profit, dishonesty, failure to procure or maintain insurance, bodily injury and property damage claims, pollution claims and suits by one board member against another.

The larger the organization, and the wealthier the board members, the greater is the need for buying D & O insurance. However, D & O can be expensive for small organizations, and ***many plans provide limited coverage*** for what you are realistically risking. All insurance policies are not created equal, and some in the D & O area tend to be written to cover you for anything except what you might really be risking. There is no hard-and-fast rule in the cost-benefit problem, and ***you must assess your own exposure***. If you are buying this insurance, have the proposal reviewed by an insurance professional other than the person selling it.

You may also explore with your agent for your homeowners' coverage whether your policy covers outside activities of this kind or whether you can purchase protection under what is called **umbrella coverage**. This is not common coverage, particularly without an extra premium, but worth the inquiry.

Temporary, workers' comp and professional liability insurance

Here are a few other types of insurance to consider as necessary. As many nonprofits are small and may not be able to afford general liability, it is sometimes practical to instead obtain **temporary insurance** for a specific event or period of time, covering things that would otherwise be under general liability for another organization.

Workers compensation insurance covers injuries and occupational diseases picked up at work. In return for being provided to employees, employers normally cannot be sued for damages when a work-related injury or illness occurs. This type of insurance is required in Washington State except for by owners of sole proprietorships and other businesses without employees. Though it's costly, it's important protection against employee lawsuits. You should verify that you have this insurance if you're not exempt.

Finally, organizations employing professionals who see clients should ensure that these professionals are covered under **professional liability insurance**, either individually or as provided by the agency, and that the agency is named as an additional insured.

EXERCISE 9

Liability Self-Assessment

On a scale of 1-5, with 1 being "not at all" and 5 being "very much so", rate how you think your organization is doing with regard to liability issues.

_____ **Does the board have adequate training/knowledge regarding their fiduciary obligations?** (*If a board member is uncomfortable with board duties, they should not accept the job. They have certain responsibilities and may need training to perform them.)*

_____ **Is the board or a committee with board-delegated powers exercising oversight over all major activities?** *(If not,they should be.)*

_____ **Are board decisions documented in minutes?**
(*This is very important. It is easy for the board to get sloppy here. Ensure minutes have enough to clearly document the board and individual board member's intentions.)*

_____ **Does each program/activity relate to your mission?**
(*One place here where boards can get in trouble is failing to pay federal tax on income unrelated to the original mission. See Chapter 4 for why this may be).*

_____ **Are any board members related to each other, or to any staff**?
(*There are many ways to do this appropriately, but a conflict of interest policy must be in place. Relations should not be involved in each other's compensation, for example.)*

_____ **Are there any loans outstanding to officers or directors?**
(*This is illegal in WA State*).

_____ **Is there a system in place for tracking donor restrictions on gifts and compliance with restrictions?**
(*Must have good record keeping here).*

_____ **Are there policies in place regarding hiring and terminating employees?**
(The majority of lawsuits brought against nonprofits pertain to illegal employee firing and discrimination.)

► **ACTION PLAN: If you are not sure how your board is doing, or want to talk to the board about how to do better, add this to your Action Plan on pages 89-90.**

Part IV

Understanding Your Organization's Finances

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Part IV
Understanding Your Organization's Finances

SCENARIO 4

The two-year old nonprofit organization Governing Kids provides funding for after school leadership opportunities for middle school students in the city. It is a small program started by a group of parents who wanted to supplement what was currently available in the district. Because it is run by a group of volunteers, and because they didn't start with a sizeable amount of money, the organization has had to fundraise every year in order to put on the programming for the next year. As a result, each year they are unable to predict exactly how much revenue they are going to have.

They recently received a large grant, but it was a restricted grant and could only be used for a certain program that the donor wanted to see used. Because the board members were new to this, they didn't understand if they needed to open a separate checking account, nor how to go about tracking that as a separate part of their budget.

Last month, Barbara, the Treasurer, wrote a check to pay for some program supplies, and because of some fund transfer issues, it bounced. They know they need to understand their cash flow issues so that that doesn't happen again.

THE SITUATION ABOVE ILLUSTRATES THE POTENTIAL COMPLEXITIES OF FINANCES, even in small organizations. As a result, to be an effective director and fiduciary you should ensure that you are educated enough about these types of issues to contribute meaningfully to financial discussions undertaken by your board. ***This is true even if you are not the treasurer, do not serve on a finance or audit committee and implicitly trust the judgment of those who do***. Although folks in those positions may know more details about the organization's finances and reporting requirements, reviewing and approving budgets and financial statements is an integral part of every director's role.

This section takes you through three basic financial statements, what they mean and how to use them in planning, as well as some general nonprofit accounting rules, and questions you should ask of your organization's finances. In addition, later chapters will provide information on how to create a budget and how to help insure your organization always has enough money on hand for its programs, as well as some suggestions for planning for the organization's financial future.

It is important to remember that a possible consequence of ignoring one's financial responsibility is that board members can be held personally liable for poorly governed funds. An even more common consequence is failing to properly and effectively serve the organization's mission.

Chapter 10

What do Directors Need to Know About Nonprofit Accounting and Finances?

Before examining financial statements, it is important that you know a bit about nonprofit accounting including the rules governing it, some financial definitions and what the financial duties are on your board.

Financial and Management Accounting

Accounting information falls into two general categories: ***financial accounting*** and ***management accounting***. The main purpose of financial accounting is to provide information to outside parties like the government, while management accounting provides information to an organization's managers for use in strategic decision-making.

Financial accounting is governed by a variety of principles and rules that are subject to audit, generally by a certified public accountant. All organizations must follow these principles and rules in order to obtain a satisfactory auditor's opinion on their financial statements. Some of these are described in more detail below.

By contrast, the information provided to management can vary depending on what the managers of the organization need for planning purposes. In general, these can be whatever works best for the organization, such as the treasurer reports many small nonprofits use. However, there are three types of statements that should be on your radar and will give you a good overall picture of the fiscal health of the organization. They are also required to be produced by accounting standards. If your nonprofit is currently not producing these, they really should be, no matter how small your budget.

- Statement of Financial Position (balance sheet)—What the company owns and owes.
- Statement of Activity (income and expenditures statement)— How activities are being funded over time.
- Statement of Cash Flows—How they're paying for their operations and their future growth.

Examples and descriptions of these statements are provided later in this chapter.

Key Accounting Concepts

In an effort to standardize the financial statements of nonprofits and to encourage consistency in accounting for contributions, the Financial Accounting Standards Board (FASB) issued two new statements of financial accounting standards (SFAS) in 1993. These are SFAAS No. 116 (Accounting for Contributions) and SFAS No. 117 (Financial Statements).

No. 116 changed how restricted contributions are recorded, required certain volunteer labor and donated services be reflected as income and expenses, and dictated that pledges be reflected on financial statements as "promise to give".

No. 117 changed the focus and presentation of financial statements to create categories of "unrestricted", "temporarily restricted" and "restricted" assets as well as required information on the nature and duration of the restrictions. It also requires nonprofits to prepare three primary financial statements described above: Statements of Financial Position, Activities and Cash Flows.

The two standards above must be adhered to when required to report to the government, such as during an audit.

To further understand financial statements, board members should also have a basic understanding of the following three accounting concepts.

1. Cash vs. Accrual Basis

Cash and Accrual are the two most common bases of keeping accounting records. With cash basis accounting, a transaction is recorded in the books only when cash changes hands. In accrual, it is recorded in the books when the transaction occurs whether it has been paid for yet or not. A major reason to use accrual is to match income and expenses in the same month that they happen to give a more accurate picture. To be in conformity with "generally accepted accounting principles", an organization should use accrual accounting.

2. Net Assets (or Fund Balance)

The fund balance or "net assets", as new accounting standards require it to be called, is unique to nonprofits. It is a term used to describe the net resources for carrying out the organization's objectives.

Total Assets - Total Liabilities = Net Assets

Organizations can have more than one fund. In a for-profit, it would be referred to as their net worth.

3. Fund Accounting

Fund accounting is a system used by nonprofits and government entities. The organization maintains separate financial records for each program that receives contributions designated for that specific program. Each set of records is called a "fund" and is considered a separate accounting entity with its own financial statements, although the organization need not keep separate bank accounts. The concept exists for reasons of attaching income and expenses to certain projects or programs. An organization, for example, may have an unrestricted general fund, where money can be used for any program, as well as a separate endowment fund that has interest each year transferred into the general fund.

Key Financial Terms

Here is a list of some of the key financial terms you should understand in dealing with financial statements.

ASSETS: Properties and resources that are owned or controlled by an entity. There are two main types—monetary and non-monetary. The amounts reported for each type are measured in quite different ways. In general, monetary consists of cash, while non-monetary assets are mainly inventory and fixed assets (or long-lived assets like buildings and equipment).

CURRENT ASSETS: Include cash accounts, certificates of deposits and other investments, and items such as receivables which will be converted to cash within one year. ***Fixed assets*** include land, buildings and equipment.

EQUITY: Sources of funds from parties other than creditors, such as donors and grants.

LIABILITIES: Debts of the organization, what is owed. ***Current liabilities*** typically include accounts payable to vendors, short-term loans due, withheld payroll taxes due, etc. ***Long term liabilities*** include long term debt, mortgages, etc.

NET ASSETS (previously called fund balances): represents the net of assets over liabilities. Three classes of net assets must be reported: unrestricted, temporarily restricted, and permanently restricted. Restrictions are determined by the conditions which donors place on their contributions.

Financial Roles

The Board Treasurer

The board treasurer's responsibility is to make sure that the following tasks are being done:

- Needed financial records are maintained;
- Actual income and expenses are compared with the approved budget, variances are notes, and corrective action taken as needed with board's approval.
- Reports on finances are made periodically to the board and general membership; and
- Any required financial reporting forms are filed.

Finance Committee

Many boards also have a finance committee. It is common, although not required, for these committees to undertake the following activities:

- Reviewing financial statements
- Making investment decisions
- Considering real estate transactions
- Meeting with the auditor
- Working with the staff to prepare the budget; and
- Reviewing accounting procedures.

This type of a committee does not remove the responsibility of financial oversight from the whole board.

Reading and Understanding Financial Statements

Board members who read financial statements can learn a great deal about the health of a nonprofit organization by examining the numerical information presented[6]. In particular, financial information helps you to:

- **Measure the organization's efficiency, using factors such as:**
  - Units of service produced compared to costs
  - Fundraising income compared to amounts spent on fundraising
  - Net income in a fee-producing program compared to the fees received
- **Evaluate the adequacy of financial resources, often through:**
  - Liquidity ratios, such as the current ratio (current assets/current liabilities)
  - Comparison of total liabilities or total assets with net assets
  - Cash flow projections
- **Seek significant financial trends by:**
  - Vertical analysis (looking at a line item as a percentage of total revenue or expense)
  - Horizontal analysis (comparing prior periods with the current period)

The same number will have different meanings for different organizations. For example, imagine an organization that shows an operating deficit for the year of $20,000. Is that a red flag? In a small organization with few reserves, such a deficit may indeed indicate serious over-spending or failure to generate revenue. In a large organization with significant reserves, $20,000 may represent less than one percent of revenue and may not be significant.

Ratios, too, have different meanings in different situations. For example, a new organization may find it spent 90 percent of its dollars on fundraising. In an established organization, such a ratio would certainly be a red flag. But on closer look, this new organization's services are delivered by volunteers, and the only paid staff they have is a fundraiser.

Ratio analysis is used to evaluate the organization's financial health. Ratios are a tool for comparing numbers representing different aspects of an organization's financial status. The value of the tool is in identifying which numbers to compare, and determining what the comparison might indicate. Although accountants have determined certain standard ranges for these ratios within some nonprofit industries (arts, libraries, human service agencies, etc.), it is most important to identify the trends in your own organization and analyze changes over time.

[6] Content and examples for this section derived from The Alliance for Nonprofit Management

Statement of Financial Position (Balance Sheet)

A "Statement of Financial Position" (also known as the balance sheet or statement of net assets) summarizes the assets, liabilities, and net assets of the organization. It is a snapshot of the entity's financial position at one moment in time and is therefore always dated "as of" a certain date. The below sample balance sheet (Form 5) as of June 30, 2004 shows the entity's financial position as of that date which includes all of the items owned or controlled as well as the debts owed by the organization. It is called the balance sheet because the total assets (summarized in one part of the statement) "balance" with (are equal to) the sum of the liabilities and net assets.

This is an example of a basic balance sheet. The balance sheet below is divided into two halves: on the top are assets; on the bottom are shown liabilities and net assets. Both halves are always in balance. Each asset, liability, and component of net assets reported in the balance sheet represents an "account" having a dollar amount or "balance." In the assets section, all the goods and property owned are listed, as well as claims against others yet to be collected. Under liabilities all debts due are listed. Under net assets is the amount that would be left if the organization were liquidated at its balance sheet value. In order to analyze balance sheet figures, you and your board should look to certain financial statement ratios, such as the current ratio, (*current assets/current liabilities*) for guidance. Another key item to look for on this sheet is whether the business will be able to pay its debts when they come due.

FORM 5—Statement of Financial Position

Statement of Financial Position (Balance Sheet)
Fictitious Youth Organization
Year Ended June 30, 2004

ASSETS	**2003**	**2004**
Cash and Cash Equivalents	$12,000	$8,000
Grants Receivable	2,000	2,500
Prepaid Expense (D&O Insurance)	500	750
Unconditional promise to give -Unrestricted	500	1,250
Fixed Assets at Cost:		
Office Equipment	5,000	0
Less: Accumulated Depreciation	-5,000	0
Net Fixed Assets	- 0 -	- 0 -
Total assets	***$15,000***	***$12,500***
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts Payable	1,500	5,000
Total liabilities	**1,500**	**5,000**
Net Assets (Fund Balance)		
Unrestricted Net Assets	13,500	7,500
Total net assets	**13,500**	**7,500**
Total liabilities and net assets	***$15,000***	***$12,500***

Statement of Activities (Income Statement)

The Statement of Activity reports revenues, expenses, and the resulting change in net assets for the year and is usually considered to be the most important financial statement. The ***bottom line*** on this statement is usually the most important single number in the accounting system. While the balance sheet shows the fundamental soundness of a non-profit by reflecting its financial position at a given date, the income statement may be of greater interest to board members concerned about ***long term health***, because it shows the record of its operating activities for the whole year and can serve as a guide in anticipating how the non-profit may do in the future. The historical record for a series of years is more important than the figure of any single year and the board should request statements with yearly comparisons.

Classes of Net Assets

The Statement of Activity charges are reported for each of the three classes of net assets (***unrestricted***, ***temporarily restricted***, and ***permanently restricted***). This statement matches the income against all the costs and outlays incurred in order to operate the company. The result is an increase or decrease in net assets for the year. The costs incurred usually consist of grants, overhead expenses, rent, supplies, depreciation, interest on money borrowed, etc.

Surplus and Deficit

If income is greater than expenses within a given period, such as a year, your organization has generated a ***surplus***. If expenses are greater than revenue, your organization experiences a ***deficit*** for the period. There is no rule that says organizations should have surpluses, deficits, or break even. Typically nonprofits budget to break even. However, your board may have budgeted to spend down cash reserves or try to create a cash reserve. Only an "unplanned" surplus, deficit, or even a break even position should be analyzed to determine its causes and to plan for the implications.

Year-to-Year Comparisons

Perhaps the most commonly used financial indicator is a comparison of budgeted revenue to actual revenue, and budgeted expense to actual expense (as shown in this example). These comparisons are made on both a monthly and a year-to-date basis. Significant variations from budget should be investigated to see whether new projections should be make based on actual experience, and/or whether managerial intervention is appropriate.

FORM 6—Statement of Activities

Statement of Activities **Fictitious Environmental Organization** *Year Ended June 30, 2004*		
UNRESTRICTED REVENUES	**Actual**	**Budget**
Earned income (investments, etc.)	$10,000	$8,500
Donations, General	12,500	15,000
Dues	2,000	3,000
Auction	5,000	4,000
GIVE Income	500	0
Total Income	**$30,000**	**$30,500**
EXPENSES		
Grants	10,000	8000
State Office Expense	5,000	5000
Membership Fees	2,300	2500
Auction Expense	4,500	4000
Postage	175	100
Copying	500	250
Foundation Expenses	500	300
Bank Fees	25	50
Total Expenses	**$23,000**	**$20,200**
Increase/(Decrease) in Net Assets	**$7,000**	**$10,300**

The Statement of Cash Flows

The Statement of Cash Flow (SCF) reports the flow of cash into and out of a company in a given year. Cash includes currency, checks on hand, and deposits in banks. There are also "cash equivalents", which are short-term, temporary investments — such as treasury bills, certificates of deposit, or commercial paper — that can be quickly and easily converted to cash. A company uses cash to pay bills, repay loans, and make investments.

The SCF reports how the organization's cash position changed during the year. Cash flow information is divided among receipts and disbursements from **investing, financing, and operating** activities. Many nonprofits ask their auditors, if they have one, to prepare this statement. As stated earlier, in the accrual system, revenue is recorded when it is earned, and expenses are recorded when they are incurred. These are not necessarily the same as the amount of cash received or paid out. Because of this, entities prepare a cash flow statement, which explains the reasons for cash changes.

The SCF reports the company's sources and uses of cash and the beginning and ending values for cash and cash equivalents each year. Key numbers in this statement show results of transactions in three categories that are sources and uses of cash, each of which will be explained in detail.

FORM 7—Statement of Cash Flows

Statement of Cash Flows
Fictitious Nonprofit Organization
Year Ended June 30, 2004
(Direct Method)

Cash flows from operations	
Cash received from contributions	$12,850
Cash received from auction	6,000
Cash received from GIVE program	500
Interest received	150
Cash expenses paid	-15,000
Net cash used by operations	4500
Cash flows from investing activities	
Purchase of Investments (CDs)	-5,000
Net cash used by investing activities	-5,000
Cash flows from financing activities	
Payment on long-term debt	-1,500
Net cash used by financing activities	-1,500
Net increase in cash and cash equivalents	-2,000
Cash and Cash Equivalents — Beginning of year	10,000
Cash and Cash Equivalents — End of year	**$8,000**

Statement of Cash Flows Detail

This section describes the three primary line items on a Statement of Cash Flows sheet.[7]

Operating activities: Net cash provided (or used) by operating activities

A nonprofit generates cash just from operating its business. Therefore, the first key number is net cash provided from operating activities. This total includes some items from the statement of earnings; for example:

- Net earnings, showing the company's profit (or loss)
- Depreciation expense

This key number also includes changes in some items from the statement of financial position:

- Inventory changes. (Increases in inventories use cash and reductions provide cash).
- Changes in accounts receivable, the sales the company has not yet been paid for. (Again, increases use cash and decreases provide cash).
- Changes in accounts payable, the cash a company owes its vendors and suppliers. (In this area, increases provide cash and decreases use cash).

The statement of cash flows adds the net cash from each type of **operating** activity and reports the company's total net cash provided (or used) by all operating activities.

Investing activities: Net cash provided (or used) by investing activities

The second key number might include investments in property (land) and equipment (computer systems, copy machines, telephone systems). Investing in such assets is a use of cash. Selling them is a source of cash.

The statement of cash flows adds the net cash from each type of **investing** activity and reports the nonprofit's total net cash provided (or used) by all investing activities.

Financing activities: Net cash provided (or used) by financing activities

The third key number includes the sources and uses of cash for financing activities. Sources of cash include what a nonprofit raises by borrowing from banks.

Uses of cash include repaying borrowed cash.

The statement of cash flows adds the net cash from each type of **financing** activity and reports the nonprofit's total net cash provided (or used) by all financing activities.

[7] Detail and examples derived from IBM Investment Guide, Financial Basics.

Questions to Ask About Financial Statements

As a board member, you should be prepared to ask questions in order to understand how your board is currently using financial statements and what they can tell you about how the organization is doing. Here are some examples of questions to ask about your board.

1. Are appropriate financial reports presented to the finance committee and/or board in a timely manner in order to make appropriate decisions?
2. What are the observations or analyses that the treasurer, finance committee and/or board has considered?
3. Are there any tax or legal considerations of which we should be aware?
4. Are revenues and expenses generally in line with the budget and plan for this year? If not, why not? Are the variances great enough to warrant action on the part of management or the board? Are upcoming revenue expectations from events and special appeals realistic given the resources being devoted to secure that revenue?
5. Have there been any unexpected events, or do we anticipate external changes, of which the full board should be aware? For example, are we experiencing any change in membership renewals from this same time last year? Should the forecast for the year be revised given the downturn in the economy?
6. Are the organization's investments managed in accordance with board-approved investment policies? How have our investments fared? What adjustments, if any, are we making for the next several months in how our investments are handled?
7. Are there any reasons why we should be worried? Are there opportunities that are going unexplored?

EXERCISE 10

What were your net assets at the end of last year? (An estimate is fine).

___

Estimate your annual budget for this year.

___

Is your budget in balance based on the last financial report your board saw?

___

If not, what needs to be done to make sure it is by the end of the year? If yes, what are the characteristics of your budget that have allowed you to stay on track?

___

___

___

___

___

___

Is your organization in a stronger financial position than the mythical foundation of page 59?

___

► **ACTION PLAN: If you aren't sure what your budget is, or whether your organization is staying on track, add this to your Action Plan on pages 89-90 as something for you to discover.**

Chapter 11

How Should You Manage the Organization's Cash Flow in the Present and into the Future?

Nonprofit organizations need cash on hand to survive sudden losses of funding and to take advantage of opportunities that may arise. In addition, they need to plan for the organization's future. This chapter discusses ways to manage both your day-to-day finances as well as think about options for building up a sustainable source of both capacity and revenue.

Cash Flow Management

"Cash flow" management refers to the need to have cash come in at the right times, so that it is available to flow out as needed, such as when you're doing a capital project over several months or there is an unexpected partnership opporuntiy that requires an outlay of some cash. Even if income matches or exceeds expenses in a given year, the cash from the income may not arrive in time to pay the bills as they come due. To avoid disruptions of business, or to take advantage of temporary cash surpluses, cash flow can and should be projected, monitored, and controlled.

The key to being able to ensure cash is available when you need it is to understand how and when cash comes in and flows out of your organization. Do you receive membership dues all in one month, and then not have any additional income during the rest of the year? Do you have large events that occur in just one or two months a year and all the bills are due then? By creating a statement of projected cash flows for the upcoming year, you will have a much better picture of whether you will have deficits in certain months and if so, how to plan for them.

A good rule of thumb is that nonprofits should have **<u>three to four months</u>** of operating expenses in reserve for rainy day emergencies. Here are some techniques to try to help improve cash flow.

In order to meet a temporary shortfall, you can:

- Obtain a loan
- Arrange for a line of credit from the bank
- Pay bills only on due date (or later if possible) unless there is a discount for early payment.
- Speed up the collection of receivables (money owed to you).
- Move up the fundraising event or campaign you are planning.
- Finance the purchase of equipment by leasing it or paying for it over time.
- Liquidate investments.
- Delay payments to vendors

To take advantage of a temporary surplus, you can

- Make short term investments in certificates of deposit, money market funds, or U.S. Treasury Bonds.
- Buy supplies on sale that you will use over the course of the year.

Planning for the Future

One of the most strategic actions a board can take for the health of the organization is to plan for future finances. Month-to-month cash flow issues are one thing, but ensuring the organization is able to exist and grow far into the future is a differently kind of planning entirely. In order to plan for the future, your board must develop a strategic plan that defines where the organization currently is and where you envision it in the future. This will give you a framework for deciding what types of organizational and investment tactics you need to consider over the long term.

Borrowing

Debt can often be used strategically to ensure that money is there when your organization needs it. Short-term borrowing should be used for temporary shortages in cash, while long-term debt is appropriate for making major purchases. The ***right time*** to consider taking a loan ***is when you know how the funds will be used and you have a repayment plan*** based on reasonable assumptions for future revenue.   However, if your organization has been operating with a persistent deficit, a loan is not the appropriate tool to fill the gap and pay ongoing operating expenses. Adding debt on top of accumulating losses is a step towards bankruptcy. If you don't have any realistic idea when or how the loan can be repaid, you should be considering other options.

Types of borrowing

Although there are many types of loans on the market, there are two types that are often used for cash flow issues. These are **cash-flow and bridge loans**, and **working capital loans**. Other loans, such as equipment financing and capital improvement financing loans can help for specific types of needs as well. Cash flow and bridge loans are great for stabilizing cash, generally repaid in 12 months, and pose the least risk to both the borrower and lender. Working capital loans are based on the entire working operations of your nonprofit and are repaid from the general income stream of your organization. Some working capital loans are created as **lines of credit** to cover seasonal or ongoing cash shortfalls. A line of credit—a loan approved up to a maximum amount to be drawn upon as needed—gives the organization the flexibility to borrow just what is needed to cover its monthly obligations. Interest is then paid only on the portion of the line that is actually borrowed. Small nonprofits can only obtain these loans with significant collateral or with the board's members guaranteeing them and as such, this should only be done with great caution.

Investing

Board responsibility for handling long-term investments is quite different from dealing with budgets and other financial matters. There are a few different strategies your board should consider when thinking about investments for your organization.

Investing in the Short-Term

Careful management of short-term cash balances can add to your organization's current income and provide the basis for an investment program which will benefit the organization in the future. Even small balances can be invested to earn some interest. For organizations with cash flow issues, an interest-bearing checking account and/or a savings account should be considered in order to earn some return on monies as they flow in and out of the organization on a daily basis.

Generally speaking, the longer funds can be committed to an investment the higher the percentage return will be (assuming the same amount of risk.) For example, cash balances in a checking account may earn little or no interest while cash invested in a risk-free six month treasury bill can yield significant interest. Therefore, it is to your advantage to identify cash which may be invested for a longer time once you have determined your cash needs and are confident that they are covered.

Investing for the Long-Term

Based on how your organization is able to save and raise money, how you invest your surplus can greatly affect the potential longevity of your organization. ***It is important to invest surplus funds as a responsible fiduciary.*** There are many options for investment, some less risky, others higher yield than others. It is important to consult a financial advisor in order to maximize your investment, while protecting your assets against undue risk. This person can advise you the most prudent plan for your organization. Common safe investment options for nonprofits that can afford to tie up cash for a longer time are Certificates of Deposits, U.S Savings Bonds, and Treasury Bills.

Endowments

If it is right for your organization, an endowment can be one way to help stabilize income. Although endowments are often associated with large-scale institutions such as universities, they can be, and often should be, a tool of smaller scale, mid-sized organizations as well. In fact many nonprofit organizationshave endowments that provide consistent income each year, which they can then choose to distribute as grants or use in other ways. However, endowments aren't for everyone, and securing the resources to start one can be very challenging. Here are some tips to know if it may be right for your organization.

Starting an endowment is a good idea if[8]:

- The organization is well established and perceived by the community as having a long-term future.
- Several hundred of the organization's donors have given $100 or more in a single year.
- There are a thousand prospects over age 50, thus making you a candidate for bequests.
- The institution has the ability to make a current investment for a future return.
- Your board is committed to a planned giving program and is willing to appropriate adequate funds, become familiar with the types of planned gifts, and set an example by making planned gifts.
- There is strong leadership and management capacity in the organization
- The organization has a history of strong financial management, balanced budgets and outside audits.

[8] List derived from Tides Canada Foundation

Other Options to Consider

Current Program Review

It is often the case that organizations get into a routine of re-funding successful programs without necessarily checking to see if they are as effective as they can be. It is important to know how cost effective the programs and services you are currently offering are to gauge if they make sense for the long-term health of the organization. One way to pursue this is to determine the "unit cost" of each program. For example, if an organization collects donations of various kinds (i.e. food, clothing, furniture)—how much does it cost them per person to collect each type of item? Would it make sense for them to focus all of their donation collections in one area and let other organizations collect the other types?

Regardless of determining unit cost, is still important to "think outside the box" and examine new ways of doing the same thing. For example, if your organization hires staff and volunteer trainers each year, investing in purchasing training materials and creating internal trainers can save the cost of having to pay for professional trainers each year—a much larger savings over time, as well as the extra benefit of building capacity in your members.

- It is important to note that mission generally takes precedence over cost in nonprofits, and for good reason. However, this does not release the board from exploring potentially new and more effective ways that the mission can be accomplished.

Partnerships

In addition to finding program cost savings, your board should be looking for opportunities to partner with other organizations. Partnerships can be win-win situations and can help increase your resources and capacity, as well as your attractiveness to donors. In fact, for many funders these days, the buzz word is COLLABORATION. Make sure you're doing this whenever and wherever you can.

Expanding your Fundraising Pool/Mix

It is often the case in local nonprofits, especially in small communities, that the same individuals are continually tapped for funds due to the multi-involvement of many individuals. As a result, your board may want to think strategically and creatively about what other types of individuals and organizations could be potential donors and begin to create a long-term plan of engaging these groups. ***The single biggest mistake organizations can make with regard to fundraising is to limit their strategies to just one or two.***

EXERCISE 11

Has your organization ever had cash flow problems, such as bouncing a check or had trouble making a payment that was due?

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If so, how were you as a board member engaged in the issue?

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What steps did board members take to rectify the problem?

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▶**ACTION PLAN: If you want to clarify what your organization's cash flow looks like, add this to your Action Plan on pages 89-90 to discuss with your board.**

Chapter 12

How Does a Board Develop a Budget?

For some boards of directors, especially those of small organizations with few programs, the budgeting process is often an annual recital of what happened last year, with slight adjustments for inflation or modest program improvements. Quickly developed and approved, this type of budget frequently relates little of the overall strategic direction of the organization.

Another approach, more integrated into the organization's mission, is when the board develops next year's plan by:

- Reviewing last year's performance including program and management achievements and fiscal health. Also, by dividing the true cost of each program by the number of people served, you can also analyze the **cost per unit of service**.
- Linking this year's programs and expenses to a strategic long-term plan.
- Developing realistic short-term measures as part of that long-term strategy.
- Estimating the costs required to achieve your objectives.
- Communicating that plan in a well-thought-out and written proposal.

Many organizations also **"zero budget"**—that is, they budget by re-justifying every expense. In this way new programs compete for budget dollars on equal terms with existing programs. Another, simpler method is for your board to start with what the nonprofit spent last year, add an amount for inflation, and then add in any new programs or services ***based on the long-term plan.*** Of course, this assumes that the programs and services provided last year are still valid and that new programs or services will only be initiated if sufficient revenue exists.

Estimating Revenue Needed

Once your board knows the level of expense, you will have answered the next major question: How much revenue is needed? You must budget for income as well as expenses. Even though unpredictable events may influence fees and contributions, you can estimate revenues with some degree of accuracy based on past experience. As with any budgeting based on the past, it is important to make adjustments for future plans and changes when you have sufficient information to anticipate.

In addition to anticipating revenue, another option may be to reduce expenses. Your board should periodically reexamine any strategic plans that have been developed for the organization. Doing so will help to identify which programs or services would be best to cut if necessary.

Reporting Results

Once the board approves the budget, your board begins the process of monitoring the budget and looking at its progress throughout the year. Budgets that are developed along the lines of corresponding financial reports allow for comparisons of budget to actual expenditures. In addition, budgets should be compared against the last two or three years to view patterns and trends.

Budgets are only estimates of what the organization projects it will spend to accomplish its stated goals, so naturally variances will occur. The treasurer's report, reviewed regularly by the board, needs to document any major variances.

A budget can be a powerful device in monitoring the organization's activities. This function is especially critical because uncontrolled expenses can seriously threaten the life of a nonprofit organization. Through budgets, the board can anticipate problems in the making and develop solutions. Understanding your organization's budgetary process can enhance your ability to function as a responsible fiduciary.

EXERCISE 12

What is the single most important thing you believe your organization spends money on?

Do you believe your budget recognizes this as the priority it is?

If your organization had a sudden 10% increase in revenue, what would it be devoted to?

How would the board make this decision?

► **ACTION PLAN: If this is an item you wish to discuss in more depth with your board, add this to your Action Plan on pages 89-90.**

Part V

Board Excellence for You and Your Board

Part V
Board Excellence for You and Your Board

SCENARIO 5(a)

Imagine your next quarterly board meeting, scheduled 6:00 pm-8:00 pm on a Thursday evening.

You arrive a little late, due to traffic, but realize as you walk in the door that others must have been stuck too. There are only 3 other people there at 6:15 pm. You and the other board members chat for awhile waiting for the others to arrive. At 6:30pm, there are only 5 of you (out of 15), but you begin the meeting.

The Chair calls the meeting to order and reviews the agenda, but notes that many of the items, while they can be discussed, can't be voted on as there is no quorum present. In addition, due to the shortage of people, several items cannot even be discussed in detail because of lack of information.

When the Treasurer makes his report, he reports that you are over budget by $1,000 because of a reimbursement he had to make when another board member spent extra funds on a recent event without clearing it with the board. As a result of this finding, one of the board members begins to discuss items unrelated to the agenda, or to the organization, and that discussion continues for 30 minutes.

Later on, two board members clash over how to invest the large unanticipated donation that was received. No decision is made and the money will continue to sit in the low-interest savings account until it is decided.

The meeting adjourns around 8:30 pm. After adjournment, the chair asks you to fill out a meeting evaluation. How do you think it went?

Or, perhaps you have been at meetings such as the following…

SCENARIO 5(b)

Imagine your next quarterly board meeting, scheduled 9:30 am-11:30 am, on a Saturday morning.

You had been sent an agenda and a copy of the financial statements you're to review at the meeting, one week ahead of time. 12 out of 15 directors show up, plenty for a quorum and good discussion. There is some social chatting for the first few minutes while people are filing in, and then the meeting starts soon after. The Chair reviews the agenda and the officers begin to give their reports.

The Treasurer reviews the financial statements with the group, highlighting important items the board should be aware of such as the causes of some of the variances in budgeted and actual numbers. She has recently begun including a quarterly balance sheet and statement of cash flows for the board to review in addition to the detailed line-item reports she usually provides. Since you've been provided with training in understanding financial statements, they are no longer quite so intimidating and you understand them.

In addition, your "mentor" board member, Jack, has been really helpful as well, with finances and also other organizational history. He's been on the board for 4 years, you only 6 months. After officer reports, the committee chairs give a report as well.

The finance committee recommends the purchase of some Treasury Bonds since the organization recently received a large, unanticipated donation. After a discussion about possible uses of the donation instead based on long-term goals, a vote is held and recorded.

Later, the board chair proposes a board retreat to do some strategic planning for the future of the organization.

Near the end of the meeting, which ends 15 minutes early, the chair passes out a meeting evaluation and asks board members to rate the meeting and provide feedback for things they'd like to see. How do you think it went?

Chapter 13

What is Board Excellence?

You've read through this workbook and now have an understanding of the financial and legal obligations you as a board member should understand and execute in order to be fulfilling your basic duties. In addition, you've read through best practices that are recommended in order to be a more effective, well-informed, safe, and accountable board. Board Excellence is a term that is used to describe all that and more. It is the entire way your board engages with the organization and each other, analyses organizational strengths and opportunities, provides opportunities for board development, and describes the organization to the community.

Consider the scenarios presented in the previous section. Does one stand out as a standard to seek, while the other as a way things often are? Does one seem frustrating and the other an effective use of your time? Board Excellence is what works for both the organization in order to advance its mission, as well as you the individual who must be engaged and willing to take it down that path.

There are many elements that make an effective and excellent board. In addition to keeping the organization on mission, engaging in strategic long-term planning, raising and investing resources wisely and ensuring that the appropriate forms are filed with various government agencies, there are the day-to-day policies, procedures and group dynamics that affect the work that you do. How many people should sit on a board? What types of committees should one have? How many terms are too many? How does one run an effective meeting? What about board members who want to be involved, but don't have the time it really takes?

Every board exists in a different context. Each board has their own history, unique characteristics, and challenges. Engaging busy people who are already involved in numerous activities, changing the way the group has always done things to keep up with current requirements, providing professional board development on a small budget, ensuring that the proper internal permissions are granted before moving forward with large expenses. How these challenges are dealt with by your board is what sets you apart and enables you to strive for excellence. Do your fellow board members truly like being a part of a team? Do they believe in the mission of the organization? Are they open an honest with each other? Are you all prepared to learn what it takes to make yourselves more effective?

The last section in this chapter provides just a few of the basics of good governance to give you a guideline of how you may wish to set up the logistics of your group. Providing your group with a strong framework can lead to a flexible board that is more informed and can respond more adeptly to changing circumstances.

Before looking at the basics of good governance, however, first take a look at Form 8 on the next page—Signs of a Board in Trouble, to gauge how your board is doing. Are any of these signs familiar in your own board? Then read the final section and think about whether you have the basics covered, and about whether the absence of any could be contributing to these signs of trouble.

FORM 8—Signs of a Board in Trouble

Signs of a Board in Trouble *(From Institute on Governance, www.iog.ca)*

This is a list of common problems and concerns within non-profit boards.

Building the Board:
- Unclear definition of roles (board, CEO, individual board members, committees)
- Inadequate knowledge of what good governance means…no target to shoot for
- Getting the board to focus on policy rather than operational matters
- Doing a good job of board orientation

Board Culture:
- Board members not pulling their weight
- Poor communication and/or unresolved conflicts within board
- Board members feeling too far removed from what is going on in the organization
- Factionalism within board (insiders and outsiders)

Meetings
- Board doesn't follow bylaws
- Poor attendance at board and committee meetings
- Low level of participation in discussions at meetings
- Discussions consistently dominated by a small number of directors
- Meetings poorly managed; lack of focus, agendas circulated late, members unprepared

Decision-Making
- Regular rubber-stamping of CEO recommendations without meaningful debate
- Preoccupation with operational detail rather than big picture issues
- Board interference in operational detail…particularly personnel and collective bargaining
- Decision deadlock or paralysis
- Board members ignoring or circumventing board policies and decisions

Planning
- Disagreement about the mission and direction of the organization
- Maintaining organizational focus within the context of changing community demographics and infrastructure
- Collaboration with organizations that often compete for the same scarce project funds
- Achieving a good balance between stakeholder input and efficient decision-making

Finances
- Maintaining financial viability
- Unplanned/unmanaged deficits
- Rapid depletion of reserve funds
- Board members don't understand financial statements
- Pressure to diversify revenues

Human Resources
- Excessive demands on and/or rapid turnover of CEO
- Major turnover of board members
- Difficulty recruiting or retaining credible board members
- Volunteer fatigue and staff burnout

Community Relationships
- Dealing with community criticism
- Managing interference by overzealous funders
- Poor communication with important stakeholders

Basics of Good Governance

Here are a few of the basics of good governance that boards may wish to consider in order to set up a framework for a successful nonprofit board experience.

Orientation and Board Book

It is imperative that new board members receive an orientation and board book as a part of beginning their board service. It not only provides them with the necessary information they will need to begin making informed decisions and providing helpful suggestions, but it also lets them know the responsibility that they have undertaken and the importance of their position. The orientation should explain the programs and responsibilities of being on your board, as well as the value it brings them to be a board member. Being paired up with a mentor that they can ask questions of, can also be helpful in helping them to become acclimated to the group. In addition new members should receive, or at least gain access to, a board book that provides a history on the organization, including its governing documents, past meeting minutes, financial statements, etc. A more detailed list of what should be in the board handbook is in Appendix N, page 107.

Board Contracts

Your boards may also choose to have a "board contract" that directors agree to and sign at the start of their service. Contracts can help a board member feel the importance of their position, and it may serve to increase their investment. An example of a board contract is in Appendix O, page 108. It can look like this one, or be modified to more effectively suit your organization.

Term Limits

It is sometimes the case that organizations have members who sit in perpetuity on a board, or who are repeatedly elected. There may be difficulty in recruiting new members, or it may just be beneficial to have the wisdom and history of these individuals. As your board grows and changes, best practices suggest two terms of 3-4 years in succession as a helpful guideline. This gives board members enough time to acquire substantial governing knowledge as well as makes it possible for board members to rotate between at least two standing committees. Having no term limits or unusually long term limits can lead to "calcification" that works against creative governing and seriously limits your ability to diversify your board by adding people with new skills, talents, experiences and perspectives. It also gives those board members, who are likely serving on multiple boards, a chance to take a break from duty and perhaps come back to serve again at a later date.

Committees

Well-designed standing committees can serve as strong governance work for your board. Even if your board is small, committees can break the work up, build expertise, and lend to a more effective use of group time. A 1995 survey by the National Center for Nonprofit Boards found that nonprofit boards have an average of 6.6 standing committees. Most frequently cited were: executive, finance/budget, and nominating. Others included development/fund-raising, program, and long-range planning. Your board should have whichever committees work best for your group.

Training

Professional development for board members is critical. It not only makes directors feel valued, but it provides them with the skills needed to do an effective governing job. Board training can be gained from the board having policies in place that provide an effective orientation for new board members, by ensuring that resources within the organization and partnership organization are tapped and expertise shared, and by planning to access community resources so that directors may gain the skills needed to do an effective job.

Effective Communication

If a board member is to have a significant role in governing an organization, and if they are to be able to minimize their exposure to legal liability, you as board members need to ensure that the information available to you about board affairs is timely and sufficient. An effective communication system should include:

- A definite agenda for each meeting
- Advance distribution of as much material as possible, preferably at least one week in advance of meetings
- A standard report package for each meeting including financials
- Periodic, timely mailing of key info boards need to consider, such as suggested policy changes, strategic plans, committee reports.
- Minutes of each meeting, which should be reviewed and approved for accuracy.

Evaluating Board and Board Member Performance

Boards need to grow and change. As a result, the board as a whole should be looked at critically by its members and evaluated for how effective it is in fulfilling the mission of the organization. Are the right policies still in place, or do they need to be changed or amended? Should different types of people and positions be recruited to the board, including some youth perhaps? Is it time to start an endowment? It is important for the health of the organization that board process and procedure be looked at critically and be allowed to grow and change with the times.

In addition, in order for board members themselves to receive effective feedback about their participation and value to the organization, there should be a periodic evaluation done perhaps each year, or each term. This might take the form of a self-evaluation, as well as a peer or board president evaluation. Director evaluations should cover such subjects as attendance at board and committee meetings, participation in board discussions, constructive criticisms and suggestions, preparedness for meetings and availability to other members.

See Appendices L and M, pages 105 and 106 for a sample individual board self-evaluation and a sample mini board assessment.

Summary

The section provided just a few of the basics of good governance to give you a guideline to think about how to provide your board with the framework needed to be a strong, effective and flexible board. There are many other best practices that you may also wish to consider, and the last section of this workbook provides you with some resources should you be interested and willing to pursue further training on a variety of topics. Whatever stage your board is currently in, all directors and boards deserve continue professional development for their own vitality, well-being and continued strive towards excellence. Thank you again for taking the time to further your board's progress by working through this book, exploring new ideas, and learning about your role in more depth.

EXERCISE 13

We've talked a lot in this workbook about types of things that you and your board may need to improve upon in order to ensure you are being a safe and accountable board. ***What are some of the things that you and your board are doing well? What makes you most proud to be a part of this board?***

Things your board is doing well

Things you are doing well

What makes you most proud to be a part of this board?

Chapter 14

Where Can You Get More Help?

Local Trainings & Other Services

Attorneys

- The Nonprofit Assistance Center, the King County Bar Association, Young Lawyer's Division, and the Seattle University School of Law sponsor a legal clinic for small nonprofits. Call *206-324-5850* for an appointment.
- Washington Attorneys Assisting Community Organizations: *1-866-288-9695* or *www.waaco.org*. Referral service for attorneys willing to provide pro-bono assistance with business matters (not litigation) statewide.

Executive Service Corps: *www.escwa.org*
Provides training and consultation to nonprofits on an affordable sliding fee scale in the areas of strategic planning, board

Nonprofit Assistance Center: www.nacseattle.org
This center has free and low cost trainings ranging from grantwriting and fundraising to legal obligations and strategic thinking.

The Nonprofit Center of South Puget Sound: www.npcenter.org
This organization offers such trainings as: Strategic Board Recruitment, Budget Monitoring, and Basic Board Certification Series. Costs range from $52 for members to $70 for nonmembers. Classes generally take place in Tacoma.

Seattle University's Not-for-Profit Leadership Program offers six board-training resource kits for downloading through *www.mnpl.org/page/16/*. They cover board responsibilities, advocacy, strategic planning, and outcome evaluation.

Volunteer Center, United Way of King County: *www.uwkc.org/nonprofit/training*
The United Way of King County offers a variety of low-cost training sessions for staff and board members, dealing with key nonprofit management and governance issues, such as strategic planning, fundraising, financial management, volunteer management, board roles and responsibilities, and human resource issues. Examples of trainings offered periodically are:

- Serving Your Community Without Being Served a Summons
- It's Your Turn: The Role of the Board Chair
- What's So Different About Not-for-Profits? For Accountants and other Financial Professionals Serving on Boards

United Way of King County also maintains an online list of trainings and similar events offered by other organizations; visit *www.uwkc.org/nonprofit/training/othertrng.asp*

Online Trainings
Many websites now offer online seminars that you can access online. Here are two examples:

- BoardSource.org is offering a teleconference presentation on executive compensation.
- NonprofitRisk.org is offering a 60 minute seminar called, Fraud Prevention for Nonprofits.

Resources & Bibliography

The following list of resources may be useful to you and your board. Those resources with an asterisk "►" are especially helpful and were used extensively in compiling this workbook.

Web Sites

If you have someone on your board who is web savvy, it is the best place to find an abundance of useful information for your board.

- ► **Alliance for Nonprofit Management**. *www.allianceonline.org*. This is a professional association of individuals and organizations devoted to improving the management and governance capacity of nonprofits. They have lots of great information for boards.
- ► **BoardSource** (formerly the National Center for Nonprofit Boards): *www.boardsource.org*. This site has some great publicly accessible resources under a "Board Information" Tab with the following subjects: Topic Papers, Board Essentials, Nonprofit Essentials, Q&A, Research and Links.
- **The Center for Philanthropy and Nonprofit Leadership**: *www.nonprofitbasics.org* They are building a resource center with lots of great information for starting, running and funding an organization.
- **Charity Channel:** *www.charitychannel.com*. This site contains online articles on the latest nonprofit happenings.
- **CharitySkills**: *www.charityskills.org*. This England-based site contains information specifically on board governance and management issues.
- **Chronicle of Philanthropy**: *http://philanthropy.com*. This is the newspaper of the nonprofit world. In addition to articles, the site also has links to a nonprofit handbook.
- **Compasspoint**: (formerly the Support Center of San Francisco): *www.compasspoint.org*. There are pull-down menus, "Resources" and "Topics", web links, a Genie, which answers nonprofit questions, and BoardCafe, a montly online newsletter with information about the nonprofit sector.
- **Foundation Center**: *www.fdncenter.org*. This site has links to resources, including links to other nonprofit sites, with summaries of what to find there.
- **Grassroots Fundraising Journal**: *www.grassrootsfundraising.org*. This site has useful fundraising information.
- **GuideStar.org**: *www.GuideStar.org*. This site has links to other nonprofit resources.
- **IdeaList**: *www.contact.org*. This is a project of the Contact Center Network. It includes information about nonprofit organizations with a searchable directory of over 9000 organizations worldwide. It also includes information for running a nonprofit covering management, fundraising, government relations and other operational issues.
- **Internet Nonprofit Center**: *www.nonprofits.org*. There are lots of FAQs on a variety of nonprofit topics based on actual questions and answers posted by nonprofit managers over the years.

- **Institute on Governance.** *www.iog.ca.* Canadian nonprofit with a lot of information on board governance.
- **Management Assistance Program (MAP)**: *www.mapfornonprofits.org.* This site has a great free toolkit for boards.
- **Minnesota Council of Nonprofits:** *www.mncn.org/infocentral.htm.* This site collects many of the important management, fundraising, and legal resources. It is organized primarily around the *Principles and Practices for Nonprofit Excellence*, which are popular guidelines on nonprofit accountability.
- **National Center for Charitable Statistics**: *www.nccs.urban.org.* This is a National repository of data on nonprofits in the U.S. The site contains some statistics on nonprofits and references to other sources of information, including.
- **The Nonprofit Center of South Puget Sound:** *www.npncenter.org.* A nonprofit organization that provides education, leadership development, consultation and peer networking connections to nonprofit organizations in the South Puget Sound area.
- **Nonprofit Genie** (California Management Assistance Partnership): *www.genie.org.* This site has some good Frequently Asked Questions (FAQs) on financial management and board governance.
- **Nonprofit Risk Management Center.** *www.nonprofitrisk.org/*. This site has great information on how to best protect your organization from liability issues.
- **Seattle Foundation**: *www.seattlefoundation.org.* The Seattle Foundation serves many local nonprofits and may be able to provide useful guidance on board excellence issues.
- **Seattle University Executive Masters Not for Profit Leadership Program.** *www.seattleu.edu/artsci/npl/default.asp.* Has some training modules available for boards that might be useful.
- **United Way King County—***www.uwkc.org/nonprofit/default.asp***.** This local site has local nonprofit trainings as well as governance and management resources.
- **United Way of the Capital Area**: *www.uwcact.org/opportunities/index.htm.* This site, based in Connecticut, has a Nonprofit Resource and Training Center. There you can find links especially for Board members which include: Guide for Board Members, Board Builder (monthly column), Board Cafe (CompassPoint's Newsletter) Board Self-Evaluation Tool (boardsource), Ensuring Your Strategic Plan Becomes a Valued Tool (article), How to Develop an Effective Board of Directors (grassrootsfundraising.org), The Organizational Life Cycle (with a good article-*Act Your Age!)*
- **Washington Secretary of State, Charities Division:** *www.secstate.wa.gov/charities/*. This site has information about tax filing for nonprofits in the state of Washington.
- **Washington State Bar Association.** *www.wsba.org/lawyers/groups/businesslaw/businesslawnonprofit.htm.* This site has a link to a great comprehensive handbook entitled, "How to Form and Maintain a Nonprofit Corporation in Washington State".
- **Women's Business Center** for a great overview of business basics. *www.onlinewbc.gov.*

Articles

- *The Basics of Budgeting: your role in developing a meaningful budget* (Board Primer), Bryan, Association Management, January 1998
- *A Board's Financial Duties: you don't need to be a financial expert to ensure that operations are on track* Jan Masaoka, Association Management, January 2002
- *Carver's Policy Governance Model in Nonprofit Organizations*, J. Carver and M. Carver, 2001, translated from French, available at *www.policygovernance.com/model.htm*.
- *Difficult Times, Restructuring Governance. Governing with Less Authority. Separating Governance from Fundraising.* Saidel and Fletcher, Nonprofit Quarterly, Fall 2003
- *How to Form and Maintain a Nonprofit Corporation in Washington State*. Young Lawyers Committee, King County Bar Association, 900 Fourth Ave Suite 600, Seattle, WA 98164-1060. Available without charge at the office or for $5 shipping and handling by mail.
- *Information on Washington's Tax Structure - Nonprofit Organizations,* Department of Revenue available at *dor.wa.gov/Docs/Pubs/IndustSpecific/NonProfit.pdf.*
- *The New Work of the Nonprofit Board*, Taylor, Chait and Holland Sept-October, 1996
- *Officers and Directors of Washington Nonprofit Corporations: Duties and Responsibilities*, Davis Wright Tremaine LLP
- *Proposed Legislation: it's impact on not-for-profit organizations*, Stanley Weiner, The CPA Journal, Nov 2003
- *Protect Your Organization Against Fraud: Ten Questions You Should Ask Your Auditor'* from *Board Member*, Vol. 7, Issue 4, April 1998 by Gerard M. Zack, CPA, CFE. Published by BoardSource.
- *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations,* BoardSource, Independent Sector, 2003

Books/Handbooks

- *A Guide for Board Members of Nonprofit Organizations*, United Way of the Capital Area
- Extraordinary Board Leadership, Eadie, 2001
- *Guide for New Directors*, Grant Thornton
- Improving the Performance of Governing Boards, Chait, Holland and Taylor, 1996
- Jossey-Bass Handbook of Nonprofit Leadership & Management, Herman & Assoc, 1994
- Legal Responsibilities of Nonprofit Boards, Bruce Hopkins
- Making Boards Effective, Zander, 1993
- Model Policies and Procedures for Non-For-Profit Organizations, McMillian, 2003
- Non-For-Profit Accounting, Tax, and Reporting Requirements, McMillian, 2003
- Non Profit Boards: Roles, Responsibilities and Performance, Duca, 1996
- Non Profit Boards: What to do and How to Do it, Tropman, 1999
- Transformational Boards, Tweeten, 2002
- Secrets of Successful Boards, Weisman, 1998
- Understanding Nonprofit Financial Statements, Dalsimer, 1996 National Center for Nonprofit Boards

Action Plan
Information Needed & Discussion Items

Use this page to create an Action Plan that you can use to help increase your Board Excellence. Write down information you want to find out, discussion items for your board, concrete action steps your board can take, and things you personally want to do or learn more about.

Information needed

Discussion items for the board

Action Plan
Action Steps for the Board and You

Concrete action steps the board can take:

Things I want to do or learn more about:

List of Appendices

APPENDIX A
IRS Publications

Here is a listing of IRS Publications that may provide helpful information for your organization. These publications can be found online at *www.irs.gov/formspubs/index.html* or by calling the IRS at 1-800-829-3676.

- **IRS Publication 526 - Charitable Contributions:** Organizations that qualify for status as a charity are described. The publication provides rules for determining the fair market value of donated property and explains limits on the size of a deduction based on 20, 30, or 50% of an individual's adjusted gross income.

- **IRS Publication 557 - Tax-Exempt Status for Your Organization:** Organizations are guided through the application procedures for obtaining tax-exempt status. Generally, these organizations must complete either Form 1023 or Form 1024 and await a ruling or determination letter from the IRS. If an exemption is granted, it may be effective as of the date of an organization's formation. In some cases, an organization may be issued an advance ruling or determination letter prior to commencing operations. Return and disclosure statements required of exempt organizations are explained.

- **IRS Publication 598 - Tax on Unrelated Business Income of Exempt Organization:**

- **IRS Publication 1391 - Deductibility of Payments Made to Charities Conducting Fund-Raising Events:** Helps sponsors of fund-raising events carefully word the extent of a donor's eligibility for a charitable contributions deduction.

- **IRS Publication 1635** – Understanding Your EIN: for more information regarding EINs.

- **IRS Publication 1771 - Charitable Contributions--Substantiation and Disclosure Requirements:** The Revenue Reconciliation Act of 1993's substantiation and disclosure requirements for donors and charities on contributions made after December 31, 1993 are reported. It is recommended that charities familiarize themselves with the new law in order to avoid failure to meet disclosure provisions that might be subject them to penalties.

APPENDIX B
Washington State Charitable Solicitations Act

STATE of WASHINGTON SECRETARY of STATE

Charities Program • 801 Capitol Way South • PO Box 40234 • Olympia, WA 98504-0234
Phone: 360-753-0863 • Fax: 360-664-4250 • E-mail: charities@secstate.wa.gov

Summary of the Registration Requirements of the
WASHINGTON STATE CHARITABLE SOLICITATIONS ACT
(Chapter 19.09 RCW)

CHARITABLE SOLICITATIONS DEFINED

A charitable solicitation is an oral or written request for money, property, or anything of value, if the request includes an appeal for a charitable purpose. An offer to sell property, goods, or services, is also a charitable solicitation if the name of a charity is used, or any implication is made that part of the proceeds from the sale will benefit a charitable purpose or be donated to charity.

ORGANIZATIONS AFFECTED

Charitable Organizations: Any entity which, to support a charitable activity, solicits contributions from the public must register with the Secretary of State, unless otherwise exempted. Charitable Organization renewals are due annually, no later than the fifteenth day of the fifth month after the end of the organization's fiscal year. Registration under the Charitable Solicitations Act is separate from, and in addition to, documents required by the state corporate law or by the US Internal Revenue Service. The filing fee for a new registration is $20.00; renewals are $10.00.

Branches, chapters and affiliates of an organization may choose to either file separately or combine their financial information into one application.

Commercial Fundraisers: Any entity which, for compensation or other consideration, directly or indirectly solicits or receives contributions for or on behalf of any Charitable Organization or charitable purpose. Commercial Fundraiser renewals are due annually, no later than the fifteenth day of the fifth month after the end of their fiscal year. All Commercial Fundraiser must obtain a $15,000 surety bond. The filing fee for a new registration is $250.00; renewals are $175.00.

Commercial Coventurer: Any entity which is primarily engaged in the making of sales of goods or services for profit, and who represents to the public that a portion of the sales price, a certain sum of money, or some other thing of value will be donated to a named charitable organization if they purchase said goods or services. The filing fee for a new registration is $20.00; renewals are $20.00.

Fundraising Service Contract Registration Form: Charitable Organizations contracting for fundraising services with a Commercial Fundraiser must submit a Fundraising Service Contract Registration Form, a copy of the written contract, and the $10.00 filing fee with the Secretary of State prior to the start of any campaign.

ORGANIZATIONS EXEMPT FROM REGISTRATION

The statute exempts religious and political activities from the definition of "charitable activity". Those activities (1) under the direction of a religious organization entitled to tax exempt status for religious purposes; or (2) subject to the reporting requirements of the Washington State Public Disclosure act or the Federal Elections Campaign Act are not subject to the Charitable Solicitations Act.

In addition, organizations raising less than $25,000 in an accounting year are exempt *if all activities of the organization are carried out by people who are unpaid for their services. The use of a Commercial Fundraiser is considered a paid service and therefore cannot be considered "exempt".*

Charitable Organizations that are exempt from registration are encouraged to file an Optional Statement for an Exempt Organization with the Secretary of State.

APPENDIX C

Application to Register as a Charitable Organization (First Page Only)

STATE of WASHINGTON · SECRETARY of STATE

Charities Program • 801 Capitol Way South • PO Box 40234 • Olympia, WA 98504-0234
Phone: 360-753-0863 • Fax: 360-664-4250 • E-mail: charities@secstate.wa.gov

APPLICATION TO REGISTER AS A CHARITABLE ORGANIZATION **FEE: $20**

PURSUANT TO RCW 19.09 AND WAC 434-120 *Make payable to "State of Washington"*

Please complete entire application or write "n/a" if not applicable. Incomplete applications will not be accepted. All documents must be typewritten or printed legibly in ink. Please do not staple application or attachments.

SECTION 1 - ORGANIZATION INFORMATION

Check One: ☐ Initial Registration ☐ Update - Registration Number: ________________

Organization's Full Legal Name:	Telephone: ( )
Mailing Address:	City, State, ZIP:
Street Address *(if different than mailing)*:	City, State, ZIP:
Fax: ( )	County *(WA State only)*:
Email:	Internet (www):

ATTACHMENT

Does the organization, or a Commercial Fundraiser or Commercial Coventurer operating on its behalf, use any other mailing, street, electronic or Internet addresses (excluding those provided above) to conduct solicitations in Washington State?

☐ Yes - Attach a list of other addresses used, including those used by Commercial Fundraisers or Commercial Coventurers, if any.
☐ No

ORGANIZATIONAL STRUCTURE

Type of organization (check one, if applicable):
☐ Association
☐ WA State Corporation
☐ Sole Proprietorship
☐ Partnership
☐ Foreign Corporation, State of Incorporation: _____
☐ Limited Liability Company

Date Incorporated/Established (mm/dd/yy):	UBI Number *(Unified Business Identifier)*:

FEDERAL TAX INFORMATION

Federal Tax ID/EIN *(Employer Identification Number)*:

Has/will the organization apply for Federal tax-exempt status? (check one) ☐ Yes ☐ No
Has the organization been granted IRS Federal tax-exempt status?
☐ Yes, exemption granted under 501(c) (______); A copy of the organization's IRS Determination Letter is enclosed (REQUIRED).
☐ No

SPECIFIC BENEFICIARIES

Attach a listing of specific beneficiaries, if any, which the organization supports and to whom assets would be distributed to in the event of dissolution.

SECTION 2 - "ALSO KNOWN AS" NAMES

List all names (excluding the organization's full legal name provided above) under which contributions will be solicited. Include acronyms, abbreviations, shortened names, Doing Business As (DBA) names, and program names, if any *(Attach an additional sheet if needed)*

CHO-1/Rev 8/04 1

APPENDIX D
Form to Amend Articles of Incorporation

STATE OF WASHINGTON
SECRETARY OF STATE

ARTICLES OF AMENDMENT WASHINGTON NONPROFIT CORPORATION

(Per Chapter 24.03 RCW)

FEE: $20

EXPEDITED (24-HOUR) SERVICE AVAILABLE – $20 PER ENTITY
INCLUDE FEE AND WRITE "EXPEDITE" IN BOLD LETTERS ON OUTSIDE OF ENVELOPE

- Please PRINT or TYPE in black ink
- Sign, date and return original AND ONE COPY to:

CORPORATIONS DIVISION
801 CAPITOL WAY SOUTH • PO BOX 40234
OLYMPIA, WA 98504-0234

- BE SURE TO INCLUDE FILING FEE. Checks should be made payable to "Secretary of State"

FOR OFFICE USE ONLY

FILED: / /

IMPORTANT! Person to contact about this filing	Daytime Phone Number (with area code)

AMENDMENT TO ARTICLES OF INCORPORATION

NAME OF CORPORATION *(As currently recorded with the Office of the Secretary of State)*		
UBI NUMBER	CORPORATION NUMBER *(If known)*	AMENDMENTS TO ARTICLES OF INCORPORATION WERE ADOPTED ON Date: ______________________

EFFECTIVE DATE OF ARTICLES OF AMENDMENT *(Specified effective date may be up to 30 days AFTER receipt of the document by the Secretary of State)*

☐ Specific Date: ______________________ ☐ Upon filing by the Secretary of State

ADOPTION OF THE ARTICLES OF AMENDMENT *(Please check ONE of the following)*

☐ The amendment was adopted by a meeting of members held on *(specify date)*: ______________. A quorum was present at the meeting and the amendment received at least two-thirds of the votes which members present or represented by proxy were entitled to cast.

☐ The amendment was adopted by a consent in writing and signed by all members entitled to vote.

☐ There are no members that have voting rights. The amendment received a majority vote of the directors at a board meeting held on *(specify date)*: ______________.

AMENDMENTS TO THE ARTICLES OF INCORPORATION ARE AS FOLLOWS
If necessary, attach additional amendments or information.

SIGNATURE OF OFFICER

This document is hereby executed under penalties of perjury, and is, to the best of my knowledge, true and correct.

Signature of Officer	*Printed Name*	*Date*

INFORMATION AND ASSISTANCE – 360/753-7115 (TDD – 360/753-1485)

805-005 (9/03)

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FOR OFFICE USE ONLY

APPENDIX E
Sample First Page of Form 990

Form **990** | **Return of Organization Exempt From Income Tax** | OMB No. 1545-0047

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)

Department of the Treasury
Internal Revenue Service

▶ The organization may have to use a copy of this return to satisfy state reporting requirements.

2004

Open to Public Inspection

A For the 2004 calendar year, or tax year beginning , 2004, and ending , 20

B Check if applicable:
- ☐ Address change
- ☐ Name change
- ☐ Initial return
- ☐ Final return
- ☐ Amended return
- ☐ Application pending

Please use IRS label or print or type. See Specific Instructions.

C Name of organization

Number and street (or P.O. box if mail is not delivered to street address) | Room/suite

City or town, state or country, and ZIP + 4

D Employer identification number

E Telephone number
( )

F Accounting method: ☐ Cash ☐ Accrual
☐ Other (specify) ▶

• **Section 501(c)(3) organizations and 4947(a)(1) nonexempt charitable trusts must attach a completed Schedule A (Form 990 or 990-EZ).**

H *and* **I** *are not applicable to section 527 organizations.*

H(a) Is this a group return for affiliates? ☐ **Yes** ☐ **No**

H(b) If "Yes," enter number of affiliates ▶

H(c) Are all affiliates included? ☐ **Yes** ☐ **No**
(If "No," attach a list. See instructions.)

H(d) Is this a separate return filed by an organization covered by a group ruling? ☐ **Yes** ☐ **No**

I Group Exemption Number ▶

G Website: ▶

J Organization type (check only one) ▶ ☐ 501(c) ( ) ◀ (insert no.) ☐ 4947(a)(1) or ☐ 527

K Check here ▶ ☐ if the organization's gross receipts are normally not more than $25,000. The organization need not file a return with the IRS; but if the organization received a Form 990 Package in the mail, it should file a return without financial data. **Some states require a complete return.**

M Check ▶ ☐ if the organization is **not** required to attach Sch. B (Form 990, 990-EZ, or 990-PF).

L Gross receipts: Add lines 6b, 8b, 9b, and 10b to line 12 ▶

Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances (See page 18 of the instructions.)

Revenue	**1**	Contributions, gifts, grants, and similar amounts received:			
	a	Direct public support	1a		
	b	Indirect public support	1b		
	c	Government contributions (grants)	1c		
	d	**Total** (add lines 1a through 1c) (cash $ ______ noncash $ ______)		1d	
	2	Program service revenue including government fees and contracts (from Part VII, line 93)		2	
	3	Membership dues and assessments		3	
	4	Interest on savings and temporary cash investments		4	
	5	Dividends and interest from securities		5	
	6a	Gross rents	6a		
	b	Less: rental expenses	6b		
	c	Net rental income or (loss) (subtract line 6b from line 6a)		6c	
	7	Other investment income (describe ▶)		7	
			(A) Securities / (B) Other		
	8a	Gross amount from sales of assets other than inventory	8a		
	b	Less: cost or other basis and sales expenses	8b		
	c	Gain or (loss) (attach schedule)	8c		
	d	Net gain or (loss) (combine line 8c, columns (A) and (B))		8d	
	9	Special events and activities (attach schedule). If any amount is from **gaming**, check here ▶ ☐			
	a	Gross revenue (not including $ ______ of contributions reported on line 1a)	9a		
	b	Less: direct expenses other than fundraising expenses	9b		
	c	Net income or (loss) from special events (subtract line 9b from line 9a)		9c	
	10a	Gross sales of inventory, less returns and allowances	10a		
	b	Less: cost of goods sold	10b		
	c	Gross profit or (loss) from sales of inventory (attach schedule) (subtract line 10b from line 10a)		10c	
	11	Other revenue (from Part VII, line 103)		11	
	12	**Total revenue** (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)		12	
Expenses	**13**	Program services (from line 44, column (B))		13	
	14	Management and general (from line 44, column (C))		14	
	15	Fundraising (from line 44, column (D))		15	
	16	Payments to affiliates (attach schedule)		16	
	17	**Total expenses** (add lines 16 and 44, column (A))		17	
Net Assets	**18**	Excess or (deficit) for the year (subtract line 17 from line 12)		18	
	19	Net assets or fund balances at beginning of year (from line 73, column (A))		19	
	20	Other changes in net assets or fund balances (attach explanation)		20	
	21	Net assets or fund balances at end of year (combine lines 18, 19, and 20)		21	

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11282Y Form **990** (2004)

APPENDIX F
Sample First Page of Form 990EZ

Form **990-EZ**

Department of the Treasury
Internal Revenue Service

Short Form
Return of Organization Exempt From Income Tax
Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)
► For organizations with gross receipts less than $100,000 and total assets less than $250,000 at the end of the year.
► *The organization may have to use a copy of this return to satisfy state reporting requirements.*

OMB No. 1545-1150
2004
Open to Public Inspection

A For the 2004 calendar year, or tax year beginning , 2004, and ending , 20

B Check if applicable: ☐ Address change ☐ Name change ☐ Initial return ☐ Final return ☐ Amended return ☐ Application pending	Please use IRS label or print or type. See Specific Instructions.	**C** Name of organization Number and street (or P.O. box, if mail is not delivered to street address) / Room/suite City or town, state or country, and ZIP + 4	**D Employer identification number** **E** Telephone number ( ) **F** Group Exemption Number ►

• *Section 501(c)(3) organizations and 4947(a)(1) nonexempt charitable trusts must attach a completed Schedule A (Form 990 or 990-EZ).*

G Accounting method: ☐ Cash ☐ Accrual Other (specify) ►

H Check ► ☐ if the organization is **not** required to attach Schedule B (Form 990, 990-EZ, or 990-PF).

I Website: ►

J Organization type (check only one)— ☐ 501(c) ( ) ◄ (insert no.) ☐ 4947(a)(1) or ☐ 527

K Check ► ☐ if the organization's gross receipts are normally not more than $25,000. The organization need not file a return with the IRS; but if the organization received a Form 990 Package in the mail, it should file a return without financial data. **Some states require a complete return.**

L Add lines 5b, 6b, and 7b, to line 9 to determine gross receipts; if $100,000 or more, file Form 990 instead of Form 990-EZ ► $

Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances (See page 37 of the instructions.)

Revenue	1	Contributions, gifts, grants, and similar amounts received			1	
	2	Program service revenue including government fees and contracts			2	
	3	Membership dues and assessments			3	
	4	Investment income			4	
	5a	Gross amount from sale of assets other than inventory	5a			
	b	Less: cost or other basis and sales expenses	5b			
	c	Gain or (loss) from sale of assets other than inventory (line 5a less line 5b) (attach schedule)			5c	
	6	Special events and activities (attach schedule). If any amount is from **gaming,** check here ► ☐				
	a	Gross revenue (not including $ ____ of contributions reported on line 1)	6a			
	b	Less: direct expenses other than fundraising expenses	6b			
	c	Net income or (loss) from special events and activities (line 6a less line 6b)			6c	
	7a	Gross sales of inventory, less returns and allowances	7a			
	b	Less: cost of goods sold	7b			
	c	Gross profit or (loss) from sales of inventory (line 7a less line 7b)			7c	
	8	Other revenue (describe ►)			8	
	9	**Total revenue** (add lines 1, 2, 3, 4, 5c, 6c, 7c, and 8) ►			9	
Expenses	10	Grants and similar amounts paid (attach schedule)			10	
	11	Benefits paid to or for members			11	
	12	Salaries, other compensation, and employee benefits			12	
	13	Professional fees and other payments to independent contractors			13	
	14	Occupancy, rent, utilities, and maintenance			14	
	15	Printing, publications, postage, and shipping			15	
	16	Other expenses (describe ►)			16	
	17	**Total expenses** (add lines 10 through 16) ►			17	
Net Assets	18	Excess or (deficit) for the year (line 9 less line 17)			18	
	19	Net assets or fund balances at beginning of year (from line 27, column (A)) (must agree with end-of-year figure reported on prior year's return)			19	
	20	Other changes in net assets or fund balances (attach explanation)			20	
	21	Net assets or fund balances at end of year (combine lines 18 through 20) ►			21	

Part II Balance Sheets—If Total assets on line 25, column (B) are $250,000 or more, file Form 990 instead of Form 990-EZ.

	(See page 40 of the instructions.)	(A) Beginning of year		(B) End of year
22	Cash, savings, and investments		22	
23	Land and buildings		23	
24	Other assets (describe ►)		24	
25	**Total assets**		25	
26	**Total liabilities** (describe ►)		26	
27	**Net assets or fund balances** (line 27 of column (B) **must** agree with line 21)		27	

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 10642I Form **990-EZ** (2004)

APPENDIX G

Sample First Page Form 990-T—Unrelated Business Income Tax

Form **990-T**

Department of the Treasury
Internal Revenue Service

Exempt Organization Business Income Tax Return
(and proxy tax under section 6033(e))

For calendar year 2004 or other tax year beginning ...., 2004, and ending ...., 20 .....

▶ See separate instructions.

OMB No. 1545-0687

2004

A ☐ Check box if address changed

B Exempt under section ☐ 501(X) ☐ 408(e) ☐ 220(e) ☐ 408A ☐ 530(a) ☐ 529(a)

C Book value of all assets at end of year

Please Print or Type

Name of organization (☐ check box if name changed and see instructions)

Number, street, and room or suite no. (If a P.O. box, see page 7 of instructions.)

City or town, state, and ZIP code

D Employer identification number (Employees' trust, see instructions for Block D on page 7.)

E New unrelated bus. activity codes (See instructions for Block E on page 7.)

F Group exemption number (see instructions for Block F on page 7) ▶

G Check organization type ▶ ☐ 501(c) corporation ☐ 501(c) trust ☐ 401(a) trust ☐ Other trust

H Describe the organization's primary unrelated business activity. ▶

I During the tax year, was the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? ▶ ☐ Yes ☐ No
If "Yes," enter the name and identifying number of the parent corporation. ▶

J The books are in care of ▶ Telephone number ▶ ( )

Part I Unrelated Trade or Business Income

			(A) Income	(B) Expenses	(C) Net
1a	Gross receipts or sales				
b	Less returns and allowances .... c Balance ▶	1c			
2	Cost of goods sold (Schedule A, line 7)	2			
3	Gross profit (subtract line 2 from line 1c)	3			
4a	Capital gain net income (attach Schedule D)	4a			
b	Net gain (loss) (Form 4797, Part II, line 17) (attach Form 4797)	4b			
c	Capital loss deduction for trusts	4c			
5	Income (loss) from partnerships and S corporations (attach statement)	5			
6	Rent income (Schedule C)	6			
7	Unrelated debt-financed income (Schedule E)	7			
8	Interest, annuities, royalties, and rents from controlled organizations (Schedule F)	8			
9	Investment income of a section 501(c)(7), (9), or (17) organization (Schedule G)	9			
10	Exploited exempt activity income (Schedule I)	10			
11	Advertising income (Schedule J)	11			
12	Other income (see page 9 of the instructions—attach schedule)	12			
13	**Total** (combine lines 3 through 12)	13			

Part II Deductions Not Taken Elsewhere (See page 9 of the instructions for limitations on deductions.) (Except for contributions, deductions must be directly connected with the unrelated business income.)

14	Compensation of officers, directors, and trustees (Schedule K)	14	
15	Salaries and wages	15	
16	Repairs and maintenance	16	
17	Bad debts	17	
18	Interest (attach schedule)	18	
19	Taxes and licenses	19	
20	Charitable contributions (see page 11 of the instructions for limitation rules)	20	
21	Depreciation (attach Form 4562) 21		
22	Less depreciation claimed on Schedule A and elsewhere on return 22a	22b	
23	Depletion	23	
24	Contributions to deferred compensation plans	24	
25	Employee benefit programs	25	
26	Excess exempt expenses (Schedule I)	26	
27	Excess readership costs (Schedule J)	27	
28	Other deductions (attach schedule)	28	
29	**Total deductions** (add lines 14 through 28)	29	
30	Unrelated business taxable income before net operating loss deduction (subtract line 29 from line 13)	30	
31	Net operating loss deduction	31	
32	Unrelated business taxable income before specific deduction (subtract line 31 from line 30)	32	
33	Specific deduction (Generally $1,000, but see line 33 instructions for exceptions)	33	
34	**Unrelated business taxable income** (subtract line 33 from line 32). If line 33 is greater than line 32, enter the smaller of zero or line 32	34	

For Privacy Act and Paperwork Reduction Act Notice, see instructions. Cat. No. 11291J Form **990-T** (2004)

APPENDIX H
Property Qualifying for Tax Exemption

Qualifying activities include:

- Public property.
- Cemeteries, churches, parsonages, convents, and groups.
- Property used for character building, benevolent, protective or rehabilitative social services, camp facilities, veteran or relief organization-owned property, property of nonprofit organizations that issue debt for student loans or that are guarantee agencies.
- Administrative offices of nonprofit religious organizations.
- Nonprofit organizations engaged in procuring, processing etc. blood, plasma or blood products.
- Nonprofit organizations, property connected with operations of public assembly halls or meeting places.
- Nonprofit day care centers, libraries, orphanages, homes or hospitals for the sick or infirm, outpatient dialysis facilities.
- Nonprofit homes for the aging.
- Nonprofit organizations, property used in providing emergency or transitional housing to low-income homeless persons or victims of domestic violence.
- Nonprofit organizations, property available without charge for medical research or training of medical personnel.
- Nonprofit cancer clinics or centers.
- Nonprofit organizations, property used for transmission or reception of radio or television signals originally broadcast by government agencies.
- Schools and colleges.
- Art, scientific and historical collections and property used to maintain such collections, property of associations engaged in production and performance of musical, dance artistic, etc., works, property to be used for exempt purposes in future, fire engines, implements, and buildings of cities, towns or fire companies, humane societies.
- Water distribution property owned by nonprofit corporations or cooperative associations.
- Property owned or used for sheltered workshops for handicapped.

APPENDIX I

Legal Compliance Checklist for 501(c)(3) and other Types of Nonprofits

Based in part on materials prepared by the National Economic Development & Law Center, 2201 Broadway, Suite 815, Oakland, CA 94612; 510-251-2600; fax 510-251-0600; www.nedlc.org

The following checklist is distributed for informational purposes only and should not be construed as legal services to any organization or individual. The checklist should be used as a starting point for a nonprofit to evaluate whether it is following Washington and federal reporting requirements and laws. Some of the items listed below are not mandated by law but are sound business practices an organization should follow to help ensure that the organization avoids problems. There are numerous other laws and reporting requirements that a nonprofit may have to comply with which are not included in this checklist.

Nonprofits should regularly assess their compliance with the following legal formalities:

Monitoring by the Board

- ✓ The corporation furnishes each director and officer with a copy of the corporation=s articles of incorporation and bylaws.
- ✓ The corporation assigns the responsibility for meeting all filing and reporting requirements to appropriate directors and staff.
- ✓ The board or a board committee regularly determines that all filing and reporting requirements have been met in a timely manner, or that appropriate and timely corrective action has been taken.

Personnel/Employment

- ✓ The corporation has applied for and been assigned a federal identification number by the Internal Revenue Service (IRS).
- ✓ The corporation complies with the reporting requirements of the Texas Workforce Commission, including the filing of Form C-1 and, if required, quarterly wage reports along with the payment of unemployment insurance tax.
- ✓ The corporation withholds federal income taxes and federal social security and Medicare taxes from taxable wages paid to employees, pays the employer share of taxes, and deposits all such funds in a timely manner and with the appropriate IRS forms.
- ✓ The corporation maintains personnel records for at least four years.
- ✓ The corporation obtains a completed IRS Form I-9 and Form W-4 from all new employees.
- ✓ The corporation furnishes each employee with a completed IRS Form W-2 by January 31 for the previous calendar year.
- ✓ The corporation files quarterly wage reports (IRS Form 941) with the IRS.
- ✓ The corporation posts or provides to its employees the required employment notices, including notices and posters required by the Texas Workers= Compensation Commission, Texas Payday Law, EEOC, OSHA, and US Department of Labor. See *www.twc.state.tx.us/ui/lablaw/posters.html* for a list of required posters.
- ✓ The corporation complies with wage and hours laws (including the Fair Labor Standards Act and Texas Payday Act), workplace safety laws, and nondiscrimination laws (including Title VII and the Americans with Disabilities Act).
- ✓ The corporation complies with its employee benefit plan requirements.
- ✓ The corporation has adopted an updated personnel policy manual and complies with the personnel policies and procedures contained in the manual.
- ✓ The corporation complies with the IRS rules governing the status of independent contractors, prepares proper documentation of all independent contractor agreements, and reports compensation to independent contractors on IRS Form 1099 MISC.
- ✓ The corporation provides to each employee from whom the corporation did not withhold any income tax a noticeabout the Earned Income Tax Credit, by providing the employee with IRS Notice 797.

Federal Tax and Financial Filings and Reports

- ✓ The corporation files annual tax information returns (IRS Form 990 or 990-EZ). If the corporation has unrelated business income, it files IRS Form 990-T.
- ✓ The corporation obtains an annual financial audit from an independent auditor and, if required by federal funding sources, the corporation obtains an A-133 audit.
- ✓ The corporation engages legal counsel to conduct an annual review of its past year=s operations and coming year=s proposed operations to identify any conflicts and inconsistencies with the information previously provided to the IRS, and for an opinion on whether the corporation is or will be engaged in unrelated business activity.
- ✓ The corporation complies with IRS disclosure, substantiation, and reporting requirements for charitable contributions received.
- ✓ The corporation observes the IRS prohibition on political campaign activities.
- ✓ For corporations within the IRS advance ruling period, the corporation conducts an annual review to determine its compliance with public charity status requirements and obtains a final ruling on its public charity status from the IRS in a timely manner.
- ✓ The corporation observes the limitations on lobbying activities and maintains appropriate records to document its lobbying expenditures and activities.
- ✓ If the corporation lobbies and utilizes the 501(h) election, it makes appropriate filings with the IRS to comply with lobbying registration, disclosure, and reporting requirements.
- ✓ If the corporation has an employee benefit plan, the corporation makes annual benefit plan filings (IRS Form 5500) as required.

Other Filings and Reports

- ✓ The corporation has applied for and maintains the appropriate property tax exemptions with the county assessor.
- ✓ The corporation files Form 9.01 with the Secretary of State every four years.
- ✓ The corporation has obtained a nonprofit mailing permit to use special bulk postal rates.

Liability Protection

- ✓ The corporation understands the policy limits of insurance policies, including: the events covered, exclusions, amount of coverage, deductibles, whether policies are Aoccurrence@ or Aclaims made@ policies, and any gaps in coverage.
- ✓ The corporation maintains appropriate commercial general liability insurance, with reasonable exclusions and limitations, with coverage for the acts and omissions of the organization and its employees and volunteers in the amount of at least $500,000 for each person, $1,000,000 for each single occurrence for death or bodily injury, and $100,000 for each single occurrence for injury to or the destruction of property.
- ✓ The corporation maintains appropriate bonding for those persons who handle its funds, with reasonable limitations and exclusions.
- ✓ The corporation maintains, as applicable, errors and omissions or other professional liability insurance, with reasonable exclusions and limitation
- ✓ The corporation maintains appropriate director's and officer's liability insurance, with reasonable exclusions and limitations, or annually reviews the affordability of such insurance.
- ✓ The corporation maintains appropriate property and automobile insurance, with reasonable limitations and exclusions.
- ✓ The corporation maintains appropriate workers' compensation insurance, with reasonable limitations and exclusions.
- ✓ The corporation maintains appropriate employment practices liability coverage, with reasonable limitations and exclusions.
- ✓ The corporation has copies of executed waivers of liability for volunteers and clients.
- ✓ The corporation has adopted policies and procedures to modify risks and monitors their implementation.
- ✓ The corporation promptly advises insurance companies of facts that could give rise to claims in accordance with notice provisions of the policies.

Operations

- ✓ The corporation has selected a bank after comparing and negotiating rates and fees.
- ✓ The corporation has authorized at least two persons as check signers.
- ✓ The corporation appropriately invests its assets that are held for investment.
- ✓ The corporation maintains an up-to-date copy of its articles of incorporation, bylaws, 501(c)(3) tax exemption application and determination letter, and franchise tax exemption letter from the Texas Comptroller and keeps a copy at its principal office.
- ✓ The corporation maintains a seller's permit from the Texas Comptroller for items it sells.
- ✓ The corporation maintains on record with the Texas Secretary of State a current name and address for its registered agent.
- ✓ The corporation has obtained a sales tax exemption from the Texas Comptroller.
- ✓ The corporation has obtained other federal, state, or local licenses as required for its activities.
- ✓ The corporation prepares and maintains for at least three years adequate and correct books and records of account, including records relating to all income and expenditures, and prepares or approves an annual report of financial activity.
- ✓ The corporation, unless it falls under a state statutory exception, makes all of its financial records available to members of the public for inspection.
- ✓ The corporation prepares and maintains minutes of board, committee, and member meetings for a minimum of three calendar years following the end of the fiscal year.
- ✓ The corporation maintains copies of notices of board and member meetings, written waivers of notice, consents to votes taken without a meeting, and approvals of all minutes.
- ✓ The corporation maintains copies of written director and officer resignations, proxies, and similar documents.
- ✓ The corporation maintains an alphabetized list of members (if any), with name, address, and class of membership.
- ✓ The corporation makes available for public inspection a copy of its federal tax exemption application, IRS tax exemption determination letter, and IRS Forms 990 from the previous three years, and provides a copy on request.
- ✓ The corporation complies with its bylaws, including the provisions on the terms of directors, election of officers, quorums, and obtaining approval for certain actions. The corporation holds all meetings it is required to hold and provides proper notice of meetings.
- ✓ The corporation has at least three directors, and has two different directors serving as president and secretary.

Transactions

- ✓ The corporation maintains a procurement policy to ensure that purchases are at a fair market value or are otherwise favorable to the corporation and, if applicable, the corporation complies with federal procurement standards.
- ✓ The corporation maintains a financial system that requires receipt of written invoices prior to payment for any services or goods.
- ✓ The corporation conducts appropriate investigations to ascertain that loans, leases, and other transactions are at fair market value or are otherwise favorable to the corporation.
- ✓ The corporation prepares appropriate documentation in support of all transactions with directors, officers, or other insiders, and to demonstrate the reasonableness of all compensation.
- ✓ The corporation has adopted a conflict of interest policy for transactions and meets all requirements for approval of transactions involving a conflict of interest including transactions with corporations under its control.
- ✓ The corporation engages legal counsel to review proposed contracts and agreements, corporate obligations to perform acts that might jeopardize its tax exempt status, and whether there are appropriate safeguards to assure that corporate funds granted to other organizations are being used for tax exempt purposes.
- ✓ The corporation receives the benefits of, and meets its obligations under, all leases, loans, contracts, partnerships, joint ventures, and similar agreements.
- ✓ If the corporation is the fiscal agent for another organization, it monitors the other organization's performance and compliance with all corporate formalities.

APPENDIX J
Sample Whistle Blower Policy
National Council of Nonprofit Associations

General
{organization name} (Organization) Code of Ethics and Conduct ("Code") requires directors, officers and employees to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. As employees and representatives of the Organization, we must practice honesty and integrity in fulfilling our responsibilities and comply with all applicable laws and regulations.

Reporting Responsibility
It is the responsibility of all directors, officers and employees to comply with the Code and to report violations or suspected violations in accordance with this Whistleblower Policy.

No Retaliation
No director, officer or employee who in good faith reports a violation of the Code shall suffer harassment, retaliation or adverse employment consequence. An employee who retaliates against someone who has reported a violation in good faith is subject to discipline up to and including termination of employment. This Whistleblower Policy is intended to encourage and enable employees and others to raise serious concerns within the Organization prior to seeking resolution outside the Organization.

Reporting Violations
The Code addresses the Organization's open door policy and suggests that employees share their questions, concerns, suggestions or complaints with someone who can address them properly. In most cases, an employee's supervisor is in the best position to address an area of concern. However, if you are not comfortable speaking with your supervisor or you are not satisfied with your supervisor's response, you are encouraged to speak with someone in the Human Resources Department or anyone in management whom you are comfortable in approaching. Supervisors and managers are required to report suspected violations of the Code of Conduct to the Organization's Compliance Officer, who has specific and exclusive responsibility to investigate all reported violations. For suspected fraud, or when you are not satisfied or uncomfortable with following the Organization's open door policy, individuals should contact the Organization's Compliance Officer directly.

Compliance Officer
The Organization's Compliance Officer is responsible for investigating and resolving all reported complaints and allegations concerning violations of the Code and, at his discretion, shall advise the Executive Director and/or the audit committee. The Compliance Officer has direct access to the audit committee of the board of directors and is required to report to the audit committee at least annually on compliance activity. The Organization's Compliance Officer is the chair of the audit committee.

Accounting and Auditing Matters
The audit committee of the board of directors shall address all reported concerns or complaints regarding corporate accounting practices, internal controls or auditing. The Compliance Officer shall immediately notify the audit committee of any such complaint and work with the committee until the matter is resolved.

Acting in Good Faith
Anyone filing a complaint concerning a violation or suspected violation of the Code must be acting in good faith and have reasonable grounds for believing the information disclosed indicates a violation of the Code. Any allegations that prove not to be substantiated and which prove to have been made maliciously or knowingly to be false will be viewed as a serious disciplinary offense.

Confidentiality
Violations or suspected violations may be submitted on a confidential basis by the complainant or may be submitted anonymously. Reports of violations or suspected violations will be kept confidential to the extent possible, consistent with the need to conduct an adequate investigation.

Handling of Reported Violations
The Compliance Officer will notify the sender and acknowledge receipt of the reported violation or suspected violation within five business days. All reports will be promptly investigated and appropriate corrective action will be taken if warranted by the investigation.

Audit Committee Compliance Officer
{organization name} Management Staff

APPENDIX K
Sample Conflict of Interest Policy

The standard of behavior at the ____ Organization is that all staff, volunteers, and board members scrupulously avoid conflicts of interest between the interests of the ____ Organization on one hand, and personal, professional, and business interests on the other. This includes avoiding potential and actual conflicts of interest, as well as perceptions of conflicts of interest.

I understand that the purposes of this policy are to protect the integrity of the ____ Organization's decision-making process, to enable our constituencies to have confidence in our integrity, and to protect the integrity and reputations of volunteers, staff and board members. Upon or before election, hiring or appointment, I will make a full, written disclosure of interests, relationships, and holdings that could potentially result in a conflict of interest.

This written disclosure will be kept on file and I will update it as appropriate. I understand that the purposes of this policy are to protect the integrity of the ____ Organization's decision-making process, to enable our constituencies to have confidence in our integrity, and to protect the integrity and reputations of volunteers, staff and board members.

Upon or before election, hiring or appointment, I will make a full, written disclosure of interests, relationships, and holdings that could potentially result in a conflict of interest.

This written disclosure will be kept on file and I will update it as appropriate. In the course of meetings or activities, I will disclose any interests in a transaction or decision where I (including my business or other nonprofit affiliations), my family and/or my significant other, employer, close associates will receive a benefit or gain. After disclosure, I understand that I will be asked to leave the room for the discussion and will not be permitted to vote on the question.

I understand that this policy is meant to supplement good judgment, and I will respect its spirit as well as its wording.

Signed: ________________________

Date: __________________________

This sample is taken from "Boardroom Dancing", a handbook for nonprofit boards written by Jan Masaoka and Jude Kaye of CompassPoint Nonprofit Services.

APPENDIX L
Individual Board Member Self-Evaluation
United Way King County

Individual Board Member Self-Evaluation

Use the following questions for individual board member evaluation. For board members answering yes to these questions, they are likely to be fulfilling their responsibilities as board members.

	Yes	No	Not Sure
1. Do I understand and support the mission of the organization?			
2. Am I knowledgeable about the organization's programs and services?			
3. Do I follow trends and important developments related to this organization?			
4. Do I assist with fund-raising and/or give a significant annual gift to the organization?			
5. Do I read and understand the organization's financial statements?			
6. Do I have a good working relationship with the chief executive or board chair?			
7. Do I recommend individuals for service to this board?			
8. Do I prepare for and participate in board meetings and committee meetings?			
9. Do I act as a good-will ambassador to the organization?			
10. Do I find serving on the board to be a satisfying and rewarding experience?			

APPENDIX M

Mini Board Assessment

United Way King County

Mini Board Self-Assessment Survey

Review the list of basic board responsibilities. Indicate whether, in your opinion, the board currently does a good job in an area or whether the board needs to improve its performance.

	Does Well	Needs Work
Organization's Mission		
Strategic Planning		
Program Evaluation		
Fund-Raising		
Fiscal Oversight and Risk Management		
Relationship with Chief Executive		
Board-Staff Relationship		
Public Relations and Advocacy		
Board Selection and Orientation		
Board Organization		

APPENDIX N
Board Book
Grant Thornton

Board Book and Orientation*.*
A thorough board manual can include the following materials. (Remember to keep each item as concise as possible.)

The board
- Board members listing and bios
- Board members terms
- Board statement of responsibilities
- Committee and task force job and descriptions

Historical references of the organization
- Brief written history and/or fact sheet
- Articles of Incorporation
- Bylaws
- IRS determination letter
- Listing of past board members

Strategic framework
- Mission and vision statement
- Strategic framework or plan
- Current annual operating plan

Minutes from recent board meetings

Policies pertaining to the board
- Policy on potential conflicts of interest
- Insurance policy coverage
- Travel/meeting expense reimbursements

Finance and fundraising
- Prior-year annual report
- Most recent audit report
- Current annual budget
- Form 990
- Banking resolutions
- Investment policy
- Current funder list

Other information
- Annual calendar
- Web site information
- Promotional material

APPENDIX O
Sample Board Contract
The National Council for Voluntary Organisations

Director Contract between _________________ and ________________.

1. You have been elected onto the board with effect from ________. You can serve for three years, with an option for re-election for a further three years, after which you will have to step down from the board. You may reapply to join the board after one year, but re-election is at the board's discretion.
2. Should you at any time wish to resign from the board you should do so by writing to the Chairperson of the board. Reasons should be given if they relate to the organization and its activities.
3. Should you not attend 3 consecutive meetings of the board without giving apologies, you will automatically lose the right to be a board member.
4. You have the right as a board member to:
   - Have equal status and voting rights with all the other board members
   - Receive training which relates to any area of the board's work
5. Your individual responsibilities are to:
   - Attend board meetings regularly. If you are unable to attend you should tell the chairperson;
   - Understand and be fully committed to the aims and principles of the organisation
   - Challenge all incidents that contravene the organization's equal opportunities policy;
   - Take a share of the board's work by offering to work on a sub-committee of the board;
   - Support all decisions once they have been agreed by the board;
   - Respect the confidentiality of board matters and discussions.
6. An orientation will be organized for you which will help you to get involved in the board. In addition the organization will provide opportunities for you to meet other board members, members of staff and familiarize yourself with the organization, its policies, plans and financial status.
7. Your joint responsibilities with all the other board members are to:
   - Accept legal responsibility for the workers of the organization;
   - Act as employers for the workers of the organization;
   - Decide overall policy for the organization's work within the guidelines laid down by members;
   - Be satisfied that within the constraints of resources, the organization is meeting its aims;
   - Take a long term view of how the work of the organization should develop;
   - Try to ensure that funding for the organisation continues;
   - Ensure that all board member responsibilities delegated to paid staff and individual members of the organisation are carried out.
8. Board members are required to declare any interests which may result in conflict while they are serving on the board.

Board member's declaration

- I have read and understood the provisions of the board member contract
- I have received and read the induction material for new board members and understand my duties and responsibilities as a board member
- I undertake to familiarize myself with the organization's policies, objectives, plans and financial position.
- I shall declare all conflicts of interest as and when they arise. If at any time these conflicts hamper my ability to perform my role as board member, I shall resign from the board.
- I shall keep all the proceedings at board member meetings confidential and shall not discuss any of the issues with the press / media without clearance from the Chairperson.

Signed ____ Date ________________________________

APPENDIX P
IRS Revenue Ruling 87-41 Factors List for Determining Independent Contractor Status

The twenty factors stated by the IRS in Revenue Ruling 87-41 for determining Independent Contractor Status. The IRS provides a process for determining whether a person is an employee for purposes of federal employment taxes and income tax withholding. A Form SS-8 is completed and returned to the IRS by the employer.

1. Instructions
A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the RIGHT to require compliance with instructions.

2. Training
Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner.

3. Integration
Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business.

4. Services Rendered Personally
If the services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.

5. Hiring, Supervising and Paying Assistants
If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status.

6. Continuing Relationship
A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.

7. Set Hours of Work
The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.

8. Full Time Required
If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.

9. Doing Work On Employer's Premises
If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required.

10. Order or Sequence Set
If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such a person or persons retain the right to do so.

11. Oral or Written Reports
A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control.

12. Payment By Hour, Week, Month
Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor.

13. Payment of Business and/or Traveling Expenses
If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities.

14. Furnishing of Tools and Materials
The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship.

15. Significant Investment
If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. Special scrutiny is required with respect to certain types of facilities, such as home offices.

16. Realization of Profit or Loss
A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

17. Working for More than One Firm at a Time
If a worker performs more than minimal services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

18. Making Service Available to General Public
The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.

19. Right to Discharge
The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications.

20. Right to Terminate
If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.
The IRS provides a process for determining whether a person is an employee for purposes of federal employment taxes and income tax withholding. A Form SS-8 is completed and returned to the IRS by the employer.