

T H E G U I D E F O R

COMMUNITY
FOUNDATION

B O A R D M E M B E R S

SECOND EDITION

Prepared by
BoardSource and the Council on Foundations

Contributions from
Sandra Hughes, Ellen Bryson, Karen Green,
Andras Kosaras, Heather Scott, and Marla Bobowick

**BOARDSOURCE**
Building Effective Nonprofit Boards

Formerly the National Center for Nonprofit Boards

**COUNCIL** on FOUNDATIONS

**T H E G U I D E F O R
C O M M U N I T Y
F O U N D A T I O N
B O A R D M E M B E R S**

Second Edition

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Sandra Hughes, Ellen Bryson, Karen Green,
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BOARDSOURCE

BoardSource is dedicated to increasing the effectiveness of nonprofit organizations by strengthening their boards of directors. Through its programs and services, BoardSource:

- provides solutions and tools to improve board performance
- acts as a conveyer and facilitator in the development of knowledge about boards
- promotes change and innovation to strengthen governance
- serves as an advocate for the value of board service and the importance of effective governance.

BoardSource is a 501(c)(3) nonprofit organization.

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COUNCIL ON FOUNDATIONS

Vision

The Council's vision for the field is of

A vibrant, growing, and responsible philanthropic sector that advances the common good.

We see ourselves as part of a broad philanthropic community that will contribute to this vision. We aim to be an important leader in reaching the vision.

Mission

The Council on Foundations provides the opportunity, leadership, and tools needed by philanthropic organizations to expand, enhance, and sustain their ability to advance the common good.

To carry out this mission, we will be a membership organization with effective and diverse leadership that helps the field be larger, more effective, more responsible, and more cooperative.

By "common good," we mean the sum total of conditions that enable community members to thrive. These achievements have a shared nature that goes beyond individual benefits.

By "philanthropic organizations," we mean any vehicle that brings people together to enhance the effectiveness, impact, and leverage of their philanthropy. This includes private and community foundations, corporate foundations and giving programs, operating foundations, and public foundations, as well as emerging giving and grantmaking mechanisms involving collective participation.

Statement of Inclusiveness

The Council on Foundations was formed to promote responsible and effective philanthropy. The mission requires a commitment to inclusiveness as a fundamental operating principle and calls for an active and ongoing process that affirms human diversity in its many forms, encompassing but not limited to ethnicity, race, gender, sexual orientation, economic circumstance, disability, and philosophy. We seek diversity in order to ensure that a range of perspectives, opinions and experiences are recognized and acted upon in achieving the Council's mission. The Council also asks members to make a similar commitment to inclusiveness in order to better enhance their abilities to contribute to the common good of our changing society.

To learn more about the Council on Foundations, which offers a wide range of resources on philanthropy, including a job bank, conferences and workshops, publications, and distance learning opportunities, visit the Council's website at www.cof.org.

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*We dedicate this publication to the memory of Judith O'Connor,
former president and CEO of BoardSource
and former chief operating officer of the Council on Foundations,
in honor of her warm spirit and passionate work for the sector.*

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Introduction

WELCOME TO THE BOARD

As a new community foundation board member, you're embarking on one of the most exciting journeys a nonprofit volunteer can undertake. Most of you have already served on nonprofit boards. Others live in the community you are serving and have insights into its strengths and needs. Some of you are familiar with foundations and may even have your own family foundation or donor-advised fund. But whatever your background, you've been invited to join the board because of your skills and knowledge of the community. Serving on the board of a community foundation differs from other nonprofit volunteering because as a community foundation board member you are not only an advisor, but also a fundraiser and grantmaker. The Council on Foundations and BoardSource have prepared this guide to help you apply your skills as quickly and as easily as possible, and adapt them to a framework that might be unfamiliar to you. We hope this guide will be of assistance and will help make your experience as rewarding as possible.

WHAT'S COVERED IN THE HANDBOOK?

We have done our best to answer the questions most new board members seem to ask:

- What is a community foundation and how does it work?
- How is the board structured?
- How is it different from being on other kinds of nonprofit boards?
- What are my legal, ethical, and social responsibilities?

In the appendixes, we have included the National Standards for U.S. Community Foundations, along with compliance indicators, developed by veteran community foundation board and staff members. These documents lay out the field's minimum practices as a guide to sound policies and accountable practices. We have also included white papers on the Sarbanes-Oxley Act and conflicts of interests that address recent developments and legal issues relevant to community foundation boards.

In 2006, Congress passed new legislation that made significant changes to the operation of donor advised funds and supporting organizations by community foundations. For a comprehensive analysis of the Pension Protection Act of 2006, visit the Council on Foundations website at www.cof.org.

Although this handbook is designed to assist you as you take up your board member duties, its overview of community foundations will neither take the place of the deeper insights you'll gain over the years nor replace legal, financial, or any other necessary expert advice. It is our hope that you will find the handbook a useful introduction and that it will help you navigate the community foundation landscape.

BOARDSOURCE

BoardSource, formerly the National Center for Nonprofit Boards, uses its programs and services to enable organizations to fulfill their missions by helping build strong and effective nonprofit boards. As the world's largest, most comprehensive publisher of materials on nonprofit governance, BoardSource offers a wide selection of books, DVDs, and CDs, and provides assistance and resources to nonprofit leaders through workshops, training, and an extensive website. BoardSource governance consultants work directly with nonprofit leaders to design specialized solutions to meet organizational needs and assist nongovernmental organizations around the world through partnerships and capacity building.

COUNCIL ON FOUNDATIONS

The Council on Foundations is a membership organization that serves the public good by promoting responsible and effective philanthropy. For more than five decades, it has helped board members, trustees, and foundation staff in their day-to-day grantmaking activities. The Council's effectiveness requires an ongoing commitment to quality, communication, collaboration, discovery, reflection, and learning. Through one-on-one technical assistance, conferences, workshops, research, publications, and legal services, the Council on Foundations addresses important issues and challenges that face foundations and corporate funders every day.

SPECIAL THANKS

BoardSource and the Council on Foundations thank the Charles Stewart Mott Foundation for supporting the first edition of this guide. We also thank Sandra Hughes, Ellen Bryson, and the community foundation CEOs and board members who helped build on the concept, giving us great insight. Finally, we thank all other Council on Foundations and BoardSource staff who reviewed this guide countless times to ensure the accuracy of the content.

Section 1

What Is a Community Foundation?

The community foundation is a hybrid. Unlike its cousin the private foundation (whose financial base most likely comes from a single donor, family, or company), the community foundation garners its support from the public. It grows because individuals, corporations, and even government entities and other nonprofits believe in it and help its growth year after year. The community foundation is also unlike other nonprofit charities that focus on specific areas of interest, such as health care, disaster relief or the arts, or specific causes, such as heart disease or the ballet. The support provided by a community foundation is not limited to one area. The community foundation looks to the well-being of the total community, not just one part of it.

Traditionally, a community foundation has four roles. It serves as a:

- builder and caretaker of permanent community resources
- service provider to donors
- grantmaker
- convener, catalyst, and collaborator within the community

However, because community foundations reflect the changing nature of their communities, they are often as different from one another as the communities they serve are. The mission or focus of a foundation will change depending on its philosophy, stage of growth, and the size and composition of its asset base.

HOW DID COMMUNITY FOUNDATIONS START?

In 1914, The Cleveland Foundation brought the model of the community foundation to life. Before that, private foundations dominated formal philanthropy, and giving was limited to individuals or families with vast personal wealth. By forming an endowment or trust from pooled contributions managed by a bank trustee and a small group of bank-appointed volunteers who distributed the trust's proceeds, the community foundation broadened opportunities for charitable giving.

Within five years, community foundations formed in places like Chicago, Boston, Milwaukee, Minneapolis, Rhode Island, and Buffalo. Although the Depression and two world wars intervened, the community foundation movement continued to grow. By 2007, there were more than 700 community foundations in the United States alone.

What Is a Community Foundation?

According to the National Standards for U.S. Community Foundations, a community foundation is a tax-exempt, nonprofit, autonomous, publicly supported, nonsectarian, philanthropic institution with a long-term goal of building permanent, named, component funds. These funds are established by many separate donors for the broad-based charitable benefit of the residents of a defined geographic area, typically no larger than a state.

Developed by veteran community foundation board and staff, the Community Foundation Standards lay out the field's minimum practices and serve as a guide to sound policies and accountable practices.

While many factors contributed to this rapid growth, one strong impetus was the Tax Reform Act of 1969. These changes in the Tax Code, put in place to end private foundation abuses, resulted in private foundations becoming more strictly regulated. Because of the public involvement in community foundations, these requirements did not extend to them.

The 1969 Tax Reform Act made community foundations a more attractive option for many donors, primarily because of the following:

- Lifetime gifts of appreciated property to a community foundation can be deducted at full fair-market value.
- The annual deduction limit for individual gifts is higher for a community foundation gift than for a private foundation gift.

Community foundations also are free from excise tax and other requirements that apply to private foundations, enhancing their appeal to donors.

Although early community foundations were created in trust form, today most community foundations are nonprofit corporations. To be a member of the Council on Foundations or to meet the national standards, all community foundations must be tax exempt under section 501(c)(3) of the Internal Revenue Code and must meet the public support test under sections 509(a)(1) and 170(b)(1)(A)(vi).

HOW IS YOUR COMMUNITY FOUNDATION DIFFERENT FROM OTHER PUBLIC CHARITIES?

Most public charities provide direct and specific services to the community, such as feeding the hungry, providing shelter, or developing health care education. They are what people tend to think of when they use the term “nonprofits.” When donors make gifts to these organizations, they are usually making a gift to help the organization perform a specific service.

However, a community foundation, while also a public charity, is primarily a grantmaker and not a direct service provider. Rather than focus on serving a particular community need, a community foundation serves donors and the broad needs of the community. Even if your community foundation does provide direct services such as nonprofit capacity building, they are often secondary to its mission.

Finally, like other public charities, community foundations must continue to meet the public support test (see sidebar) to keep their charitable status. However, community foundations generally seek support through individual gifts in the form of substantial lifetime gifts or bequests, rather than the small annual gifts from the public that most other public charities target.

What Is the Public Support Test?

To be classified a public charity, the community foundation must demonstrate to the IRS that the community broadly supports it. Usually this means that at least one-third of its income comes from contributions from a diverse group of donors. If too much of its income comes from (1) a single donor or (2) investment income, it runs the risk of being reclassified as a private foundation.

Refer to the Council on Foundations' *Legal Compendium for Community Foundations* or *How to Calculate the Public Support Test* for more details. To order, go to www.cof.org/publications.

HOW IS YOUR COMMUNITY FOUNDATION DIFFERENT FROM OTHER FOUNDATIONS?

Like private foundations and corporate giving programs, your community foundation has a charitable purpose. However, a single family, business, political, or other limited group does not control it.

Community foundation boards are drawn from a broad community base. Unlike many private foundations, especially family foundations whose board members may serve extended terms or even for life, community foundation boards serve for shorter periods of time and most have term limits. Also, community foundation board members do not usually receive compensation for services. The national standards state that compensation is only permissible for a board member who is also the chief executive.

Most community foundations are the only one serving their area. Although multiple private foundations can and often do exist in the same geographic region, a community foundation is generally the only one serving a particular community.

HOW IS A COMMUNITY FOUNDATION STRUCTURED?

A community foundation is often called a “three-legged stool,” a term that reflects its role as fundraiser, grantmaker, and community leader.

Many community foundations add a fourth role to the mix by providing donor services. As philanthropy changes because of new donor trends, community foundations have begun viewing the lifetime giving of donors, in addition to bequests after their death, as increasingly important to their financial well-being. Providing services to attract and keep donors and next-generation philanthropists has taken on new weight.

Although some community foundations work solely within their own communities, others occasionally fund more broadly and even internationally. Some give grants in typical areas of interest (e.g., human services, arts and humanities, civic engagement), while others focus their grantmaking to address specific community problems in different ways. Most community foundations act beyond the scope of simple grantmaking by convening or taking other leadership roles for the good of the whole community.

Even the answer to the question, “Who is your primary customer?” changes depending on a community foundation’s values and business practices. Some see their primary job as building a long-term endowment. Others focus on the cultivation and service of donors. Still others see themselves primarily as grantmakers, providing leadership and expert assistance to the community. Understanding your own foundation’s mission, vision, and historic context will give you tools for setting a foundation policy that best reflects the changing needs of your community.

Common Community Foundation Functions

- building and managing a permanent endowment to meet community needs
- making broad-based grants to other nonprofit organizations
- providing community leadership, including leveraging resources and convening organizations to solve problems
- providing a central philanthropic vehicle for donors to meet their interests

HOW DOES THE STAFF WORK?

If your foundation is new or small, you may only have a chief executive—or maybe not even that. At the other extreme are community foundations with large professional staffs trained in all aspects of running a foundation.

Staff usually works in one or more of seven traditional areas:

- Executive staff works with guidance from the board to provide overall management and leadership of the foundation.
- Program staff is responsible for grantmaking activities.
- Development or advancement staff raises money or increases the foundation's assets.
- Finance staff directs financial and accounting activities.
- Donor relations staff works to meet the needs of current or potential donors.
- Communications staff puts a face on the foundation and makes it visible in the community.
- Administrative staff provides daily organization and support.

Staffing structures may differ depending on a foundation's size and age. Some may combine staff functions; for example, the advancement staff might also be responsible for donor relations and communications. In smaller foundations, the chief executive might assume responsibility for donor relations programs or have some of these tasks handled by the board at a committee level.

Typically, the chief executive oversees the daily and long-term operations of your foundation and its staff, including: hiring staff and defining job responsibilities, overseeing programs, establishing a financial infrastructure, communicating fully and frequently with the board, and acting in a leadership capacity in the community on behalf of the community foundation.

With direction from the chief executive, foundation staff provides information, assistance, and leadership. Your foundation should have clear policies to guide board and staff responsibilities beyond the bylaws that detail the chain of command, grievance procedures, and communication channels.

You and the staff should share a common vision of your foundation's work and a commitment to its mission and long-term goals. If you as a board are dedicated to establishing policy and overseeing and assessing the foundation's progress and achievements, and the foundation's chief executive and staff are committed to carrying out policy and achieving optimum performance and accountability, your interaction should be productive and positive.

Many community foundations (especially those that are mid- and larger-sized) have begun to merge these job functions, even when fully staffed. Many foundations now aim to have full-service staff, trained to work in cross-functional teams rather than in specific departments.

Section 2

What Does a Community Foundation Board Do?

What would you like to gain from your foundation board service? What legacy would you like to leave the community? A community foundation board is greater than the sum of its parts—individual board members' skills, knowledge, and dedication. Like most nonprofit organizations, a community foundation can leverage this advantage only when each individual board member is fully engaged. What follows is an overview of the collective role of the board and your individual responsibilities as a member of a community foundation board.

WHAT DOES THE BOARD DO?

First and foremost, the board governs the community foundation. The word *governance* comes from a Greek word meaning to steer or set direction. Governance also encompasses the all-important issues of authority and accountability. The board holds and exercises authority, which is granted by federal and state governments as well as the foundation's community constituents. It also provides accountability for the foundation's performance by protecting the public's interest.

WHAT ARE THE LEGAL OBLIGATIONS OF A BOARD MEMBER?

The board governs the life of the community foundation, and board members have both a moral and a legal obligation to ensure that the foundation serves the public. Under the law, a board member must meet certain standards of conduct:

- **Duty of Care** means exercising your best judgment when making decisions. Perfection isn't required, but reasonable caution is. In short, the duty of care demands active participation and thoughtful attention to the foundation by individual board members. You can fulfill this duty by learning about the foundation's programs, attending meetings, participating in discussions, and making sure you obtain the necessary information to ask appropriate questions.
- **Duty of Loyalty** means putting aside your personal and professional interests for the good of the organization. When you enter the boardroom, you are expected to focus exclusively on what's best for the foundation. A conflict-of-interest policy, signed annually by each board member, is one way to ensure this duty of loyalty.
- **Duty of Obedience** means ensuring that the foundation stays true to its mission and purpose. Board members carry out this duty by overseeing the foundation's distribution of funds and monitoring compliance with all applicable laws and regulations.

WHAT ARE THE COLLECTIVE RESPONSIBILITIES OF THE BOARD?

In the simplest of terms, nonprofit boards have three primary responsibilities: setting direction, ensuring adequate resources, and providing oversight. The following duties round out the basis of community foundation governance:

Setting direction

- Articulating the foundation's mission, vision, and values, and understand and support its objectives
- Setting policies for the operations and practices of the foundation
- Determining and overseeing the grantmaking strategy
- Establishing a "donor development" strategy

Ensuring the necessary resources

- Hiring and supporting the chief executive
- Developing a strong, effective board
- Ensuring adequate financial resources
- Putting forth a positive image of the foundation in the community

Providing oversight

- Serving as fiduciary stewards by monitoring financial performance
- Defining measures of success and monitoring the foundation's programs and activities
- Guaranteeing accountability and ensuring legal and ethical standards and compliance
- Evaluating the chief executive
- Engaging in continuous board self-assessment

WHAT WILL MAKE ME A BETTER BOARD MEMBER?

Although boards only function in their governing capacity as a collective body, individual board members have fundamental commitments to the foundation. As an individual board member, your duties include the following:

Active participation

- Attending meetings and events
- Serving on committees, carrying out assignments, and scouting for prospective donors and board members

Keeping informed

- Getting to know and thoroughly understand your foundation's mission, financial outlook, grantmaking areas, and other goals and objectives
- Preparing for board and committee meetings
- Staying abreast of related issues in your community and in the field of philanthropy so that you bring meaningful input to the board

Upholding your foundation's ethics and values

- Following the conflict-of-interest and confidentiality policies set by the board as a whole, especially the points that prohibit special favors from staff or grantees for yourself or individuals and organizations in which you have an interest
- Making sure you are acting for the good of the foundation in all things having to do with foundation finances

Supporting the foundation in every way you can

- Representing the foundation in the community; what you do and say reflects on its mission, values, and effectiveness
- Becoming comfortable speaking to the public about your foundation's mission and goals
- Taking a leadership role within the foundation's boardroom
- Keeping your ear to the ground for feedback on foundation activities

In addition, depending on your committee assignments and other volunteer involvement, you may become even more deeply engaged in the valuable work of the community foundation. Each board member has his or her personal reasons for participating, and each contributes in a unique way.

WHAT CAN I EXPECT FROM BOARD MEETINGS?

Most of you have been members of one or more boards and are familiar with board meetings. You know that the meetings are where the governance of the foundation and the work of the board get done. By law, your board is required to meet on a regular basis to carry out its oversight role. However, having a board meeting without adequate preparation may not only waste your and other board members' time, but also impinge on your ability to do your job effectively. An effective board meeting:

- Focuses on important issues related to foundation goals
- Relies on consent agendas to allocate discussion time to important issues
- Is a give-and-take experience, not a show-and-tell; provides opportunities for questions and discussions
- Is action oriented and presents issues clearly and concisely
- Begins and ends on time
- Is enjoyable, even fun at times

To ensure that members are prepared for the board meeting, the board chair and chief executive should distribute the agenda and any relevant attachments one to two weeks before the meeting.

Board Meeting Evaluation: How Did We Do?

- Was the agenda clear, supported by the right documents, and received in good time?
- Was every board member there?
- Was the meeting room conducive to our work?
- Were all of us able and ready to discuss the advance materials?
- Were the reports clear and to the point?
- Did we focus on the big picture and strategic issues instead of micromanaging?
- Did people express dissenting opinions, and were they heard with respect?
- Did the chair effectively guide the meeting and involve all board members?
- Did we make decisions and formulate plans to implement them?
- Did we begin and end on time?
- Was our meeting enjoyable?

Previous meeting minutes and committee reports are commonly included in these materials. It is essential to be familiar with these documents before coming to the meeting. They provide much of the information needed to fully participate in discussions. If you have questions about the agenda, contact the board chair, the committee chair, or the chief executive ahead of time.

The foundation leadership may choose to organize your meeting around a theme, which allows the board to focus in-depth on one or two issues, such as outreach or board development. Outside experts may be invited to bring new perspectives to your discussions. Regardless of the format, however, each meeting should fully involve board members, respond to your concerns and questions, and allow you to take advantage of each other's expertise and insights so that collectively you make better decisions on behalf of the foundation.

Each board meeting presents an opportunity for a mini-evaluation. Honestly evaluate all aspects of the board meeting, from agenda and materials to discussions and participation. Without your feedback, the foundation leadership will not be able to refocus or improve the planning and implementation of these critical gatherings. Do not hesitate to ask questions in order to be fully comfortable with board action—you, with other board members, are ultimately accountable for these actions.

Between meetings you are expected to carry out the assignments you accepted at the previous meeting. A diligent board or committee chair may follow up with you before the next meeting.

WHAT'S UNIQUE ABOUT COMMUNITY FOUNDATION BOARD SERVICE?

Community foundations fill a special niche in the philanthropic world because of their perspective and prestige. As a community foundation board member, you have probably served on a variety of nonprofit boards and much of your experience will be useful in this setting. But, as you step into this new leadership role, keep in mind the exciting and sometimes challenging nature of community foundation stewardship.

- Ultimately, community foundations are designed to have a far-ranging focus: the greater good of the entire community. The board looks after the long-term viability of the community; from its vantage point, it guides the integration of many interests through a single entity.
- Most nonprofit organizations raise money and they expect their board members to help with this process. Community foundations are in the unique position of raising and distributing charitable contributions. Both sides of this philanthropic equation fall under the board's purview.
- Most community foundations offer a dazzling array of giving options, and their boards may oversee considerable budgets. This requires a great degree of financial savvy and investment acumen from the board, particularly from its finance, investment, and audit committees. Board members need to understand financial reports and ask the right questions.
- Community foundation boards draw from all corners of the community. Board members bring with them considerable leadership experience, often from the business, government, and nonprofit sectors. Channeling a diverse and impressive array of talent and expertise into a common vision requires patience and respect from all board members, and a skilled board chair and chief executive.

HOW CAN THE BOARD BEST PROVIDE COMMUNITY LEADERSHIP?

Helping define and articulate the foundation's mission, vision, and core values is the most effective way for your board to support the community. Setting direction—the core of governance—calls for big-picture strategizing and visionary thinking. You, as a board member and a community leader, should work diligently to help the board become a vibrant, unified team moving in one direction. The foundation's impact will be enhanced if the board as a team passionately shares a clear and common vision focused on the community at large.

Undertaking a strategic thinking and planning effort is a surefire way to help the board focus. This process often starts with a strong mission statement that reflects what your foundation wants to accomplish and how it supports, or serves as a change agent for, the community. Once a mission statement is in place, the board and staff can work together to develop a strategic framework for how and when to achieve more specific goals. In the end, the board and staff will have the following elements to use as guideposts for their activities:

- statement of core values
- vision and mission statements
- strategic goals and related objectives and action plans
- program and funding priorities
- short- and longer-term budget projections
- measures of success

The board's duty then becomes to secure the necessary resources to implement and monitor outcomes and impact. Is the foundation accomplishing what it set out to do? In addition, on a periodic basis, the board should review the foundation's mission, bylaws, and other policies to ensure that they are accurate, vibrant, clear, concise, relevant, and a source of community pride.

Leadership Questions for Board Members

- Does the board have a workable strategy to manage growth and does the board want growth?
- What really matters to the foundation, to the board, and to me?
- Are there any sacred cows that we're avoiding in our discussions?
- Are we thinking creatively or just recycling ideas?
- How have we as a board contributed to the growth and effectiveness of the foundation?
- What makes me think the board is functioning well, and what do I mean by "well"?
- Does the board devote time to questions about what really matters?
- Are our committees organized around strategic issues rather than administrative functions?
- Does the board hobble the organization by keeping administrative costs so low that staffing is inadequate?
- How does the board get the foundation from here to the future?

NOTES

Section 3

How Is a Board Structured?

Although a community foundation board may be greater than the sum of its parts, larger boards are not necessarily better boards. In fact, the most effective boards are only as big as they need to be to get the job done. More important to good governance are composition and leadership: Do board leaders provide the necessary support to the board and chief executive? Does the foundation leverage its board resources through strong committees? Because a community foundation board convenes only periodically, it needs to pay careful attention to its leadership and structures.

WHAT DOES THE BOARD CHAIR DO?

As the person responsible for leading the board, the chair often exerts tremendous influence on the direction of a community foundation. Whether called “chair,” “chairperson,” or “board president,” your board leader must be committed to the foundation, be approachable and objective, and exhibit strong leadership, diplomatic, and strategic skills. As the chief volunteer officer, the board chair facilitates communications and interactions between the chief executive officer and the board members. He or she rallies the board to support the foundation and provides moral support to the chief executive.

Each board chair functions differently, depending on the community foundation’s history and culture as well as on the individual’s personal and professional experience. However, most foundation board chairs share the following responsibilities:

- cultivating an active and engaged board by reaching out to individual board members
- serving as the contact point for every board member
- assigning and support committees and task forces
- leading the board in evaluations of the chief executive, the board itself, and the foundation
- working with the chief executive to shape board meeting agendas and preside over board meetings

To meet the challenges of the position, a good board chair will work hard to earn and maintain the respect of fellow board members. Most often, this is visible in the way the chair conducts board meetings—a tricky, sometimes frustrating task. Board leaders strive for a results-oriented agenda, but they must also make sure the meeting actively involves all board members and balances the sometimes fractious but often necessary deliberations. Board chairs will also nurture strong working relationships with as many members of the board as possible.

Your board chair acts as the point person for information flowing to and from the chief executive and staff. In turn, the chief executive manages the foundation’s day-to-day operations in accordance with your organization’s directives. Both chair and chief executive need to be dedicated to advancing your foundation’s mission. Although they have different responsibilities and perspectives, they must also support, balance, and regularly communicate their concerns and ideas to each other.

WHAT DO THE BOARD OFFICERS DO?

Board officers usually include a vice chair, treasurer, and secretary, as well as the chief executive. Together, this leadership team shoulders specific additional board responsibilities. For example, the vice (or deputy) chair supports the work of the chair and functions as board leader when the chair is unavailable. The vice chair is often the chair-in-waiting, but some foundations are reconsidering this automatic succession to create new leadership opportunities on the board.

The treasurer is responsible for overseeing the foundation's fiscal activities and keeping the board informed about foundation finances. The secretary is responsible for maintaining board records, keeping the minutes, and making sure the board is aware of meeting dates and times. Depending on state law, a community foundation staff member may carry out most of the secretary's tasks (such as taking minutes and maintaining records), or the board may either combine the secretary and treasurer positions or choose to eliminate the secretary position completely.

Board officers are usually elected from a slate of candidates prepared by the governance or nominating committee. This committee often works with the chief executive and board chair to identify candidates for these leadership positions, and it usually recommends only one candidate for each officer opening (to avoid unnecessary tensions on the board). Then, the board as a whole confirms or rejects the committee's nominees. Tenure in officer positions is often one or two years, with one re-election a common practice.

HOW DOES THE BOARD INTERACT WITH THE CHIEF EXECUTIVE?

Your community foundation board is responsible for hiring, supporting, overseeing, and evaluating the foundation's president or chief executive. To do this well, the board should give the chief executive a clear job description and guidance about its expectations. During the course of the year, the board should provide ongoing support and feedback to the chief executive.

The chief executive will work most closely with the board chair, but he or she is likely to call on individual board members for their advice and professional expertise as the need arises. The chief executive may ask them to open doors, to bounce ideas off of them, or to play devil's advocates. In these instances, individual board members are acting as special advisors to the chief executive, not as a governing body; only when acting together as a full board are board members empowered to set policy.

Annually, the board should evaluate the chief executive's performance against established criteria and expectations. Although frequently conceived as a partnership, the board/chief executive relationship is also an employer/employee situation that requires professional care and handling. If the chief executive's conduct or performance requires termination, the board as a whole—not the board chair or executive committee—carries out the dismissal.

WHAT DO COMMITTEES DO?

Committees, long considered the workhorses of the board, are no longer as straightforward as they once were. The traditional board structure that once included countless standing committees is only one of many options. Many boards now look for flexible, simple ways of managing their workload while adjusting to the board's and the foundation's evolving needs.

Common Board Committees

Not every foundation will have all of these committees. Some may have only one or two, but these are the committees you're most likely to encounter:

- The **executive committee** acts on behalf of the full board between sessions; its decisions are immediately communicated to and later approved by the full board.
- The **governance (or nominating) committee** evaluates the board's composition and needs, and coordinates nominations and elections of board members and officers.
- The **finance committee** monitors the foundation's financial status, oversees the budgeting, accounting and reporting systems, and develops and monitors investment policies. Some community foundation boards separate financial reporting and investment oversight into two committees.
- The **audit committee** establishes policies and practices to prevent financial fraud, monitors the internal controls, hires the auditor, and serves as a crucial link between the board and the independent auditor. To ensure appropriate checks and balances, most community foundations have separate finance and audit committees.
- The **development committee** establishes a development strategy and creates a fundraising plan, which is then implemented by all board members.
- The **grants or program committee** develops the foundation's grant program, including its philosophy and guidelines, and oversees the grantmaking process.

Refer to *Transforming Board Structure* for greater details.

Given the range and complexity of board tasks, most community foundation boards rely on a number of standing committees to assist them in their work. Typically, these committees deal with grants and programs, board governance, fundraising, finance, and other issues. When possible, an increasing number of foundations are streamlining this structure. Not all board committees need to be permanent. When a special need is identified, your board may decide to form a task force or ad hoc committee. These time-limited working groups free the rest of the board to concentrate on strategic thinking and high-priority foundation issues. Each committee, task force, or work group should have a clear charter to conduct its work. Few hard and fast rules exist for the organization and function of these informal groups. You may want to determine the following before embarking on any task:

- How often should we meet?
- Who should belong: board members? Foundation staff? Other outside advisors?
- How big should the group be?

The goals of these work groups should reflect the strategic direction and priorities of the foundation as a whole, and their work should be regularly evaluated on this basis.

Committees, task forces, and working groups are all excellent ways to introduce outsiders with new approaches and skills to your board. Including leaders of various community constituencies in these groups can strengthen the links between your board, your foundation, and your public. It also gives people who might otherwise be too busy an opportunity to help the community without the pressures of regular board membership.

WHAT DO COMMITTEE MEMBERS DO?

Serving on a committee means giving its work your time, attention, and effort. Committee meetings are more informal than board meetings, but their output is essential to the operations of the full board. Some committees explore all the angles of a particular issue and then make a recommendation to the full board; others serve as volunteer work groups that support the efforts of staff, particularly in fundraising activities.

As an individual board member, you may move from one committee to another if your interests change or space is available. Your board or your development committee may decide to rotate board members among the standing committees to encourage different people to take on leadership roles. This helps to prevent board member burnout by splitting up the tasks and ensures that everyone has the chance to develop a broad knowledge of your board's responsibilities and the foundation's functions.

What Is a Governance Committee?

A growing trend in board governance is the establishment of a governance committee. Appointed by the entire board, this committee takes on most of the responsibilities more typically assigned to the executive committee and the nomination committee. Its main job is to ensure the highest quality of governance to safeguard the foundation's future. It also assesses overall board performance. Governance committee charges can include:

- A. Board Role and Responsibilities
 - Regularly updating collective board roles and individual board member responsibilities
 - Helping to clarify the board's agenda for the future based on the strategic plan
- B. Board Composition
 - Assessing current and anticipated needs for board composition; developing a profile of the board as it should evolve over time
 - Identifying candidates and exploring their interest and availability
 - Nominating individuals for election
 - In cooperation with the board chair, meeting annually with each director to assess his/her continuing interest in board membership
- C. Board Knowledge
 - Designing and overseeing a process of board orientation for new members
 - Designing and implementing an ongoing program of board information and education
- D. Board Effectiveness
 - Leading a periodic assessment of the board's performance
 - Providing ongoing counsel to board officers to enhance board effectiveness
 - Regularly reviewing the board's practices regarding board member participation, conflict of interest, confidentiality, etc., and suggesting improvements as needed
 - Periodically reviewing and updating the board's policy guidelines and practices
- E. Board Leadership
 - Leading in succession planning for future board leadership
 - Nominating individuals for election as board officers

If you are named committee chair, you would be expected to manage parts of the committee's work, such as planning meetings, assigning tasks, creating agendas, and communicating with the board and, as appropriate, foundation staff. Chairs, working with the chief executive and board chair, should also keep an eye on integrating their committee's work with that of other committees. At the end of the year, committee chairs often evaluate their committee's progress and report back to the board.

As mentioned earlier, your board may also establish ad hoc committees or advisory councils that include other members of the community. These councils often address special needs. Advisory councils use their knowledge of the community's situation to make recommendations to the foundation about future program development, finance and investment, grantmaking priorities, pilot projects, and other aspects of community relations.

To avoid confusion and frustration, advisory council members need to understand that they are valued as advisors. Their input and energy helps the board and staff in directing the foundation, but the board remains the ultimate decision making body.

HOW CAN WE MAKE COMMITTEES MORE PRODUCTIVE?

Many boards do not possess all of the necessary skills and expertise to do their work at an optimal level. In response, some foundations invite outsiders with specific contacts or knowledge to serve on committees or task forces. This is an excellent way to bring new talents and perspectives to the work of the board without increasing the board size. It also allows former directors to continue their involvement, and cultivates volunteers for future board service or potential donor involvement.

Some boards have turned to a zero-based committee strategy, abolishing all committees at the beginning of each year and recreating only those they deem still necessary. An evaluation process can allow the board to reassess the composition of each committee and redirect the focus of a working group as needed.

Benefits of a zero-based structure include:

- avoiding stagnation because the board is flexible and future-oriented
- increasing the number of leadership opportunities
- facilitating leadership changes

Small and particularly cohesive boards may use no committees at all. Directors manage the workload as a unified group. This kind of structure builds unity and focus, but requires effective leadership and equal commitment from every board member.

What Makes an Effective Committee?

- a clear job description and defined goals
- a chair who involves all members in the work of the committee
- members who are committed and willing to spend the needed time to accomplish tasks
- a sense of being part of the full board and not working in isolation
- an appreciation of time constraints and deadlines
- an understanding that the committee does not make decisions, but rather advises and recommends
- an evaluation process to assess its own achievements
- an understanding of when it no longer needs to exist or needs to change direction

NOTES

Section 4

Who Serves On a Community Foundation Board?

Good boards don't just happen. They require care, thought, and planning. Building and maintaining a strong board is a continuous process that should include year-round activities. The board is the public face of the foundation; who serves on the board, how they reflect and interact with the community, and what they do to ensure accountability will shape the foundation's success as a fundraising and grantmaking entity.

WHO GUIDES THE BOARD BUILDING PROCESS?

Two of the board's most important responsibilities are to continuously cultivate potential board members and to keep current board members actively engaged in the work of the foundation. Boards, however, sometimes neglect these responsibilities; they spend little time or effort strategically thinking about how to shape the board's composition in a way that matches the foundation's culture and strategic direction.

Community foundation boards have customarily used nominating committees to manage the recruitment process. Often these committees meet just a few times a year, usually in advance of an annual meeting at which new directors would be elected. Now, many foundation boards are converting the nominating committee into a governance committee that serves as the conscience of the board and addresses a broader range of governance issues.

As with many vital leadership activities, the board and the chief executive work together on board building. The chief executive often participates in many board recruitment activities, from identifying prospective board members to interviewing candidates before the election. Some chief executives will also maintain a file of resumés of community leaders, attend cultivation meetings with other board members, and solicit ideas from senior staff.

Step 1: Identify the needs of the board: the skills, knowledge, perspectives, connections, etc., needed to implement the strategic plan. What do you have? What is missing?

Step 2: Cultivate sources of potential board members and identify individuals with the desired characteristics. Ask current board members, senior staff, and others to suggest potential candidates. Find ways to connect with those candidates, get them interested in your organization, and keep them informed of your progress

Step 3: Recruit prospects. Describe why prospective members are wanted and needed. Explain expectations and responsibilities of board members, and don't minimize requirements. Invite questions, elicit prospects' interest, and find out if they are prepared to serve.

Step 4: Orient new board members both to the organization and to the board by explaining the history, programs, pressing issues, finances, facilities, bylaws, and organizational chart. Describe committees, board member responsibilities, and lists of board members and key staff members.

Step 5: Involve all board members. Discover their interests and availability. Involve them in committees or task forces. Assign them a board "buddy." Solicit feedback. Hold everyone accountable. Express appreciation for work well done.

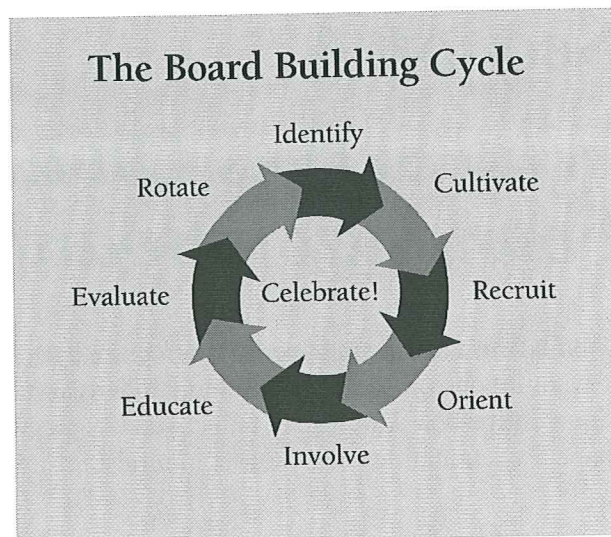
Step 6: Educate the board. Provide information concerning your mission area. Promote exploration of issues facing the organization. Hold retreats and encourage board development activities by sending board members to seminars and workshops. Don't hide difficulties.

Step 7: Evaluate the board as a whole, as well as individual board members. Examine how the board and chief executive work as a team. Engage the board in assessing its own performance. Identify ways to improve. Encourage individual self-assessment.

Step 8: Rotate board members. Establish term limits. Do not automatically reelect for an additional term; consider the board's needs and the board member's performance. Question the advisability of re-signing with members who are not active. Develop new leadership.

Step 9: Celebrate! Recognize victories and progress, no matter how small. Appreciate individual contributions to the board, the organization, and the community. Make room for humor and a good laugh.

Refer to *The Board Building Cycle*, Second Edition for more details. To order, go to www.boardsource.com.



WHAT DETERMINES BOARD SIZE?

There's no ideal standard for board size. It depends on many factors, including mission and board structure, foundation life cycle, fundraising needs, and constituencies served. State law mandates a minimum size for nonprofit boards (sometimes one, but usually three members), but the size should represent and reflect the interests of your community. According to the Council on Foundations Foundation Management Series, Twelfth Edition, the median U.S. community foundation board has 16 members.

Generally, your foundation bylaws establish board size and term limits. Most bylaws avoid a hard and fast number to ensure that board size can respond to changing conditions. Many boards opt for an uneven number of members to prevent tie votes, and increasingly boards are leaving at least one or two vacancies should an ideal candidate surface between elections. Some community foundations have board members appointed by outside entities, such as financial institutions or local elected officials, in accordance with the foundation's charter.

Experience shows that the best way to determine the size of a board is to ask, "What are we trying to accomplish and how many members do we need to do this?" If your community foundation board decides to add new members, your first step should be to examine the present membership. A board profile will help identify not only skills and strengths that are missing, but also any gaps you need to fill in community representation and diversity.

WHY IS DIVERSITY IMPORTANT?

To qualify as a charitable organization, your community foundation must demonstrate that it is supported by and serves a broad section of the public. Board composition is one way of fulfilling that mandate. Generally, board members are chosen because they are committed to the foundation's mission and have strong ties to the community. Because they set direction and oversee policies and finances, board members should be individuals who exhibit good judgment and decision making abilities. The board should also reflect the community the foundation serves. By understanding the power of diversity and by using it appropriately, a community foundation board can possess the basic tools for creating a more responsive foundation.

Socio-economic, geographic, age, and ethnic diversity, along with a variety of personal skills and professional expertise, are especially critical for a community foundation board. Diverse board members offer broad perspectives and political and community connections that will help the decision making process. They may also act as strong advocates for the foundation within the community, with potential and existing donors, and with the media.

Benefits of a Diverse Board

- A homogeneous board may not always be ready to deal effectively with problems because of an inherent near-sightedness.
- Diversity on a board breeds varying opinions, approaches, attitudes, and solutions. It requires open-mindedness, curiosity, acceptance, and responsiveness, which can ultimately facilitate understanding and willingness to work together.
- Boards are often expected to represent the foundation's community. This is a way to create accountability and form a link with the community.
- Diversity can inspire innovation and creative thinking.
- A diverse board sends a message and sets a powerful example for the foundation, its grantees, and the community it serves.

HOW CAN PROSPECTIVE BOARD MEMBERS BE IDENTIFIED?

Every board should have a process in place to recruit new members so that board openings can be filled or expanded when you decide the time is right. Be on the lookout for qualified, prospective board members throughout the year, not just when a candidate is needed to fill an opening. Once you've located them, make an effort to introduce your candidates to other board members and to educate your prospects about the board and foundation, perhaps even persuading them to participate on an advisory council to get their feet wet.

When an opening is about to become available, your board may ask the governance committee to compile a list of candidates for the spot. Board member cultivation and recruitment is not a responsibility that can or should be delegated solely to the chief executive. Committee members usually poll their peers, the foundation chief executive, senior staff, community leaders, board members of other nonprofit organizations, and even the local media for names of candidates who will fit the bill.

Once a list of candidates has been compiled, the governance committee reviews the prospects, weighing what each candidate might bring to the table against what the board needs. After the field is narrowed, recruitment begins in earnest. Your board chair, the chief executive, or other board members who have shared interests or personal relationships with the candidates usually make personal appeals. Their task is to convince prospective members of the advantages that they can bring to your board and that they in turn can realize from board membership.

WHAT DO NEW MEMBERS NEED TO KNOW ONCE THEY JOIN THE BOARD?

Once a member is elected to the board, the community foundation should provide adequate orientation. An effective orientation is likely to include practical presentations on board member responsibilities, legal obligations, and financial statements. In addition, new board members will benefit from information-sharing sessions with staff, briefings by outside experts, and other educational opportunities.

An orientation session should be held before new board members attend their first board meeting. This will help the new board member participate fully on the board as quickly as possible. Organized by the governance committee, the board chair, the chief executive, or all of the above, the orientation should give new board members a sense of:

- the foundation's mission, programmatic priorities, and other activities
- the foundation's finances
- foundation structures and processes
- board member roles and responsibilities
- donor development, including potential contributors and fundraising expectations
- community outreach and opportunities for foundation leadership

How Long Do Board Members Serve?

Check your bylaws. Most community foundations use terms and term limits as a way of enabling their boards to remain fresh and focused. By creating board openings on a regular basis, they ensure a continuous flow of new ideas and greater community involvement in the foundation. Knowing you have a finite term of service helps you concentrate your attention and efforts, as well as avoid burnout. Commonly, community foundation board members serve three-year terms, with a limit of two consecutive terms. Many also limit the total number of years of service—usually three terms or nine years.

Orientation programs work best when half of the program is about the foundation itself, and the other half is about the board member's role on the board. Usually, key board and staff members take part in the orientation. Many foundation boards are also finding that new board member orientation is a fun and effective way of connecting new and old board members to each other and updating current board members on their commitment to the foundation.

WHAT CAN MEMBERS EXPECT AFTER HAVING SERVED ON THE BOARD FOR A WHILE?

Building a strong board is a team activity. Make it clear from the start that everyone is expected to participate and follow through on his or her assignments. Encourage board members to get involved in areas where they can use their expertise to support the foundation but will also have opportunities for learning, personal growth, and leadership development.

For new and seasoned board members alike, it is a good idea to step back once in a while and see if the community foundation has shifted from its guiding purpose—review the mission statement, examine whether the committee structure still works, plan special workshops on fundraising, go on site visits, or hold a board retreat. You might also consider having an independent consultant conduct exit interviews of board members. These exit interviews can capture information to help you improve how your board functions.

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Section 5

What Laws Govern a Community Foundation?

Your community foundation is subject to federal, state, and local laws. Your responsibility as a board member is to ensure that all foundation activities meet the applicable legal requirements. You should also be on the lookout for other possible legal pitfalls, some of which are not clearly defined.

WHAT IS THE BOARD'S RESPONSIBILITY REGARDING LAWS THAT AFFECT THE FOUNDATION?

Because the foundation is a product of both state and federal law, it is subject to various legal rules and regulations. Board members need to be familiar with at least four areas: the federal tax codes, the state nonprofit corporation law, the state charitable solicitation laws, and the state law regarding conflicts of interest.

Many legal issues your foundation faces in its day-to-day work can be understood by raising awareness of these four areas. However, other laws will also apply, depending on the circumstances. Therefore, your board should make sure the foundation uses a qualified, experienced attorney as needed. A "do-it-yourself" approach could be embarrassing and expensive and result in unwitting violations of the law. The Council on Foundations' legal services department can provide general information on legal issues.

WHAT RULES ARE IMPOSED BY THE FEDERAL TAX CODE?

Your federal tax-exempt status depends on meeting the requirements established by the federal Tax Code. As described in Section One of this guide, community foundations must be tax exempt under section 501(c)(3) of the Internal Revenue Code and must meet the public support test under sections 509(a)(1) and 170(b)(1)(A)(vi). In addition, community foundations in trust form must meet the standards contained in section 1.170 A-9(e)(11) of the income tax regulations. In order to maintain this tax-exempt status, the most important thing to remember is that your foundation's activities must further charitable purposes. The following rules ensure that this is true:

1. Tax Filing

The primary federal tax filing requirements for community foundations are Form 1023 (Application for Recognition of Exemption), which is filed at the time the community foundation is formed, and Form 990, which is filed each year and reports the foundation's income, expenses, and changes in its assets. Form 990 also includes a wealth of other information, including lists of grants made, names and addresses of board members, compensation paid to staff and outside consultants, and the ways in which the foundation meets the public support test. Generally speaking, community foundations must provide any recently filed Form 990s (although names and addresses of the foundation's donors may be omitted). Additional information about the disclosure requirements for Form 1023 and Form 990 may be found on the Council on Foundations website.

1. Excess Benefit and Intermediate Sanctions

Tied to the requirement that activities meet charitable purposes is the rule that a foundation may not use its assets in any way that results in “private inurement”—unfair or unreasonable tangible or economic benefits to individuals or companies. A subset of this rule, called “excess benefit transactions,” prohibits unfair dealings between the foundation and insiders. Insiders are individuals in positions that enable them to exercise influence over foundation affairs, such as the chief executive, the chief financial officer, and all directors. Under recent IRS regulations, stiff penalties can be assessed against an insider or foundation manager who knowingly approves such a transaction. These penalties are called “intermediate sanctions” because they do not necessarily require revoking the foundation’s tax-exempt status.

3. Unrelated Business Income Tax

Although the foundation’s purposes must always be charitable, it may carry on activities that do not substantially further those purposes as long as those activities do not become ends in themselves. Income from activities that do not further a charitable purpose is generally referred to as unrelated business income and, unless an exemption or exclusion applies, must be reported on Form 990-T. Any tax owed must be paid. What income is related or unrelated is often a complex question. For example, the activity of investing the foundation’s assets does not substantially further the community foundation’s charitable purposes (except by producing income, which, for these purposes, doesn’t count). However, most investment income, including interest, dividends, royalties, and most rents, is exempt from tax, as is income from activities carried on substantially by volunteers and from activities that the foundation does not undertake on a regular basis. Community foundations are most likely to have unrelated business income if they sell advertising in print publication, accept contributions of subchapter-S stock, or include debt-financed property in their investment portfolios.

4. Gift Substantiation and Disclosure

Gifts to the foundation are generally tax deductible for the donor. However, if the gift exceeds \$250, that deduction is not available unless the donor has a receipt from the foundation. For cash gifts, the receipt needs to state the amount received. For gifts of property, the receipt must describe the property but should not indicate any value. The receipt must also state that no goods or services were provided to the donor in exchange for the gift.

The foundation must also provide a receipt to any donor who makes a gift of more than \$75 and receives goods or services in return. That receipt needs to state a good-faith estimate of the value of those goods or services, and it must inform the donor that the eligible deduction is the value of what was contributed less the value of any goods or services. These rules do not apply to contributions from private foundations and other charities.

Gifts to donor-advised funds require a receipt from the foundation, regardless of the amount of the contribution, and must include a statement that the foundation has exclusive legal control over the contributed assets.

Is Your Foundation in Trust Form?

State trust law regulates foundations established in trust form. The internal rules governing these structures are usually stated in the trust agreement itself. Most foundations in the trust form still use bylaws as guiding principles but do not have articles of incorporation.

WHAT IS THE STATE NONPROFIT CORPORATION LAW?

As stated in Section One, most community foundations are nonprofit corporations. Although the federal tax law regulates tax-exempt status for all foundations, those in the corporate form are also regulated through the state nonprofit law. This law governs the internal legal structure of the foundation. The details of how an organization is run are generally defined within its articles of incorporation and its bylaws.

The articles of incorporation are the document that creates the corporation. These articles are filed with the appropriate state authority and can be amended if major changes occur. The articles of incorporation should also be filed with IRS Form 1023.

The required content of the articles varies from state to state, but, as a rule, they are short and easily understood, and usually include:

- name and tax-exempt purpose
- duration (usually in perpetuity)
- office location
- number, names, and addresses of the initial board members
- provisions for distributing assets should a foundation be dissolved

Bylaws supplement what is not included in the articles and are generally used to guide the board's structures, actions, and decisions. Helpful in preventing or resolving conflicts and disagreements, they also protect your foundation from potential problems by clearly outlining rules about procedures, rights, and powers.

Good practice includes regularly reviewing the bylaws and updating them, when appropriate, to ensure that they accurately reflect how the organization works. Although your board must vote to amend the bylaws, they may appoint a task force to review them and bring suggested revisions to the board. It is also important to consult your legal advisor to make sure changes don't contradict state law or other governance documents. Once the bylaws are revised, send a dated copy to the entire board.

WHAT ARE THE STATE LAWS REGARDING CONFLICTS OF INTEREST?

As part of its nonprofit corporation law, each state has some legal mechanism for dealing with situations in which the interests of a board member are different from the interests of the foundation. These situations are called conflicts of interest, and although there are many types, most involve participation of a board member in a decision that could result in a personal direct, tangible, or economic benefit. If your board doesn't guard against conflicts of interest, you may find yourself personally liable.

Resolving conflicts of interest is the board's duty. The board may decide to create a conflict-of-interest policy for board and staff members. It may also decide to develop a task force or committee to analyze and deal with conflicts as they arise, with the board chair or some other committee member designated as the lead person in these deliberations. For

Bylaws Usually Include:

- foundation name and location
- statement of purpose
- election, roles, and terms of board and officers
- meeting guidelines (quorum, frequency)
- board structure (size, any standing committees)
- compensation and indemnification of board members
- chief executive role
- bylaw amendment process
- dissolution of the organization
- variance power (see page 40)

more information on conflicts of interest, see Appendix 2, “Conflicts of Interest at Foundations: Avoiding the Bad and Managing the Good.”

Because many conflicts of interest arise from simple ignorance of policies and procedures, disclosure may end the matter. But if a board or staff member acts in spite of having a conflict of interest, you may want to impose disciplinary action that could include removal from the board. Most conflict-of-interest guidelines also call for you to disclose conflicts associated with potential grantees. Usually the member is excluded from discussing or voting on matters where a conflict of interest may exist. Staff also must abstain from any decision making on transactions that could result in a conflict of interest.

WHAT ARE THE STATE CHARITABLE SOLICITATION LAWS?

Most states (currently 40 and the District of Columbia) require charitable organizations to register with their state attorney general or other designated state agency before they can solicit residents for charitable contributions. Because this is a mandated requirement, the board should make sure that the community foundation is in compliance with the state law. It is also important to note that community foundations serving a geographic region that includes more than one state may need to register annually in multiple jurisdictions. Registration in more than one state may also be necessary if the community foundation continues to solicit gifts from donors who have moved to another area.

Registration usually involves completing required paperwork and filing an initial registration fee. Registration is usually updated annually. To find out what the charitable solicitation laws are for your state, refer to www.nasconet.org.

If you hire professional fundraisers to assist your staff members with development projects, they have to register with the state and annually comply with state charitable solicitation laws as part of their business. If you retain outside fundraising consultants, verify that they are in compliance with any applicable state laws before signing a contract.

DOES THE SARBANES-OXLEY ACT APPLY TO FOUNDATIONS?

July 30, 2002, was pivotal in the life of publicly traded U.S. companies. On this date, the U.S. Congress passed the Sarbanes-Oxley Act, which helped redefine accountability and transparency. Enacted in response to several notable corporate scandals, the Sarbanes-Oxley Act affects publicly traded U.S. companies and focuses primarily on financial accountability. It contains elements that have notable governance implications, including:

- **Audit committees:** Every publicly traded company must have an independent audit committee. Independence refers to the absence of

Employment Taxes

Like all employers, community foundations must follow federal law in withholding federal taxes from employee wages and paying the employer's share of federal employment taxes (e.g., Social Security and Medicare). The IRS takes an exceedingly dim view of an organization's failure to make timely deposits of these taxes.

Board members—including board members who are not compensated—can be held personally responsible for these payments, even if they did not know that the organization was derelict in meeting its obligations. Fortunately, this happens only rarely, but it can be tempting for an organization under financial stress to postpone federal tax deposits to meet payroll or pay the rent. Board members of such organizations should make certain that federal tax deposits continue to be paid as they come due.

management team members on the committee. Members of the committee may not be compensated for their service and at least one of them must be “financially literate.” The committee’s duty is to hire and supervise the activities of the auditor.

- **Auditor restrictions:** A new lead auditor should be assigned every five years. The auditor may not provide non-audit services to the company while carrying out the audit functions.
- **Finances:** No personal loans are allowed to staff and board members. Also, the chief executive and the chief financial officer must certify the accuracy of financial statements.
- **Disclosure:** Companies need to disclose detailed internal control procedures, including a conflict-of-interest policy.

Two elements of the Sarbanes-Oxley Act apply to all corporations, nonprofit and for-profit alike:

- **Document destruction:** The act makes it a crime for any enterprise to alter in any way or destroy litigation-related documents or files.
- **Whistle-blower protection:** Under the act, it is a federal crime for any enterprise to retaliate against whistle-blowers. In addition, public companies must establish a confidential mechanism to deal with an employee reporting on possible misuse of the corporation’s funds by management.

Although the Sarbanes-Oxley Act was enacted because of the wrongdoings of corporate executives, the nonprofit sector has not been immune from its share of scandals. Community foundation board and staff leaders are wise to establish good governance practices that address concerns related to ethics, transparency, and accountability. For more detailed analysis, see Appendix 3, “The Sarbanes-Oxley Act and Implications for Nonprofit Organizations.”

ARE THERE OTHER POTENTIAL LEGAL ISSUES?

You may encounter myriad other legal issues in running your foundation, including:

- state tax exemption (sales, property, etc.)
- employment law (including tax reporting and withholding requirements)
- insurance (directors and officers, general liability)
- intellectual property (copyright, trademark, and patent)
- securities law (including the Philanthropy Protection Act of 1995)

It is impossible to identify or have in-depth knowledge of every issue that might arise. As a board member, chances are you will never be required to know more than the basics. However, the health and legal compliance of the foundation ultimately rests in your hands. It is up to you to fulfill your oversight role.

If legal violations do occur, the state or federal government can apply a variety of enforcement tools, including fines and civil or criminal actions against individuals or the foundation. In egregious cases, the organization could lose its charitable status. Therefore, most boards rely on the guidance of experienced legal counsel to help them stay abreast of relevant legal issues.

CAN I BE HELD PERSONALLY LIABLE AS A DIRECTOR OF THE FOUNDATION?

The answer, unfortunately, is not a simple yes or no. Although claims against nonprofit boards are rare and personal liability for directors is even rarer, such liability can occur. Ordinarily, directors who fulfill their board responsibilities and act within the scope of their duties will not face personal liability for their service. However, where a director fails to fulfill her legal duties or engages in such acts as conflicts of interest, gross negligence, fraud, or criminal conduct, the risk of personal liability is much higher. Personal liability can also result if a director is involved in certain violations of the Tax Code.

The good news is that there are several mechanisms to protect foundation directors from personal liability. State corporation law, the federal Volunteer Protection Act, and other state volunteer protection laws all contain provisions that are designed to protect directors, especially volunteer directors, from potential liability. In addition, both general liability insurance and directors and officers liability insurance (see page 31) are available to add further protection. Board members should consult with the foundation's legal advisor to ensure that the foundation is taking full advantage of protection available under the law and to determine whether and to what extent insurance is appropriate.

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Section 6

What Are the Board's Fiduciary Responsibilities?

One of your most important roles as a board member is to ensure that the fiduciary responsibilities of the community foundation are being met at a high standard. This section cannot possibly document all of the financial and accounting standards that apply. Rely on your accountant, legal advisor, and foundation staff to keep you properly informed. This section serves only as a general overview.

WHAT IS MEANT BY “FIDUCIARY DUTY”?

Simply, this is the legal responsibility for investing money or acting wisely on behalf of another. Managers of a charitable entity—in your case, the community foundation—have fiduciary obligations to that charity. As stewards of the public trust, board members must always act for the foundation's good, exercising reasonable care in all decision making and protecting the foundation from unnecessary risk.

Your fiduciary responsibility has two sides. The first, fiscal oversight, requires the board to review and decide on the foundation budget, ensure appropriate internal controls are in place, monitor the foundation's financial performance, and make sure an independent audit is conducted. The second, investment oversight, requires the board to establish investment policies, hire investment managers, and review the foundation's portfolio performance.

To prevent financial fraud, the board must make sure that the foundation clearly defines job descriptions and responsibilities for board and staff. Financial and accounting procedures range from who signs checks and handles cash to who approves expenses and how and for what credit cards can be used. A clear conflict-of-interest policy, as well as regular external audits, is also part of the equation.

HOW DOES THE BOARD OVERSEE THE FOUNDATION'S BUDGET?

Your foundation's budget should reflect the strategic priorities and provide a framework for program management and overall administrative decisions. Your yearly operating budget is a blueprint of the foundation's annual program objectives. Some of the board's budget responsibilities are to secure needed funding for administrative operations and regularly examine your foundation's financial statements.

The board should verify that all filing requirements and tax obligations are fulfilled in a complete and timely way. This includes filling out and filing the IRS Form 990 and regularly withholding and paying employment taxes. The foundation must also document and justify executive compensation.

Convening an audit committee of board and outside members for planning and review is also part of the board's oversight role.

HOW DO COMMITTEES HELP THE BOARD CARRY OUT ITS FIDUCIARY RESPONSIBILITIES?

The finance committee oversees development of the budget and annual operating plan and makes recommendations to the full board. It monitors the foundation's fee structures and accounting policies and recommends financial guidelines for items such as a reserve fund. The finance committee also reports any financial irregularities, concerns, or opportunities to the full board, oversees compliance with bylaws and board policies, and generally protects the foundation, board, and staff from undue risk.

In keeping with the spirit of the Sarbanes-Oxley Act, most community foundation boards have an audit committee that is separate from the finance committee. The audit committee's responsibility is to recommend, work with, and oversee an external auditor. The committee ensures that the auditor has full access to financial and related records, reviews the auditor's report, and arranges for the auditor to meet with the full board once a year. An excellent practice is for the committee to meet with the auditor without foundation management or staff present to allow for free exchange of information. The committee recommends acceptance or rejection of the audit to the board. For more information, see Appendix 3, "The Sarbanes-Oxley Act and Implications for Nonprofit Organizations."

The investment committee ensures that the board's investment policies are up to date and properly implemented. It proposes, but does not set, policies that support the foundation's mission, values, and strategic direction. It is up to the board to adopt these recommendations. This committee also oversees investment performance and investment manager hiring and termination, being alert to any potential conflicts of interest or excess benefit transaction.

WHAT DO YOU PERSONALLY NEED TO KNOW ABOUT ACCOUNTING RULES AND REGULATIONS?

Because you as an individual board member can be held personally responsible for proper oversight, you'll want to read, understand, and question your foundation's financial statements. The American Institute of Certified Public Accountants (AICPA), the Financial Accounting Standards Board (FASB), and the IRS all provide guidance and regulation to nonprofits.

The American Institute of Certified Public Accountants (AICPA) is a national professional organization for all certified public accountants. Its interpretations and rulings focus primarily on the generally accepted accounting principles, used in preparing and auditing financial statements. Many of AICPA's directives concerning nonprofits can be found in The AICPA Not-for-Profit Audit and Accounting Guide, an AICPA publication. A number of AICPA's recent Statements of Position also deal with nonprofit accounting, such as SOP-98-2. SOP-98-2 requires organizations to carefully review communications that include a request for contributions and, based on standards it sets forth, determine whether all or part of the expenses of the communication should be allocated to fundraising. The AICPA has a free, downloadable, and customizable Audit Committee Toolkit: Not-for-Profit Organizations at www.aicpa.org.

What Every Board Should Ask about the Foundation's Financial Health

- Is our financial plan consistent with our strategic plan?
- Is our cash flow projected to be adequate?
- Do we have sufficient reserves?
- Is the endowment growing?
- Are we regularly comparing our financial activity with what we have budgeted?
- Are our expenses appropriate?
- Do we have the appropriate checks and balances to prevent errors, fraud, and abuse?
- Do we have a process in place that ensures compliance with donor intent?

The Financial Accounting Standards Board (FASB) also develops standards for accounting and financial reporting. Although compliance with FASB standards is voluntary, failure to comply will result in a qualified opinion by your outside auditors. Note that although a qualified opinion is often interpreted as negative, financial statements prepared on a cash basis receive a qualified opinion that is not necessarily negative.

Many FASB standards apply to charities. The four most frequently encountered are:

- Statement of Financial Accounting Standards No. 116: Accounting for Contributions Received and Contributions Made
- Statement of Financial Accounting Standards No. 117: Financial Statements of Not-for-Profit Organizations
- Statement of Financial Accounting Standards No. 124: Accounting for Certain Investments Held by Not-for-Profit Organizations
- Statement of Financial Accounting Standards No. 136: Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.

Standard No. 136 addresses the financial reporting treatment of agency endowment funds held at community foundations. You can find more information in the Council on Foundations publication *Community Foundations and Agency Endowments*, listed in the resource guide.

WHAT IS THE BOARD'S ROLE REGARDING FINANCIAL STATEMENTS?

The board treasurer and foundation staff prepare the financial statements. Board members are responsible for reviewing and ensuring their accuracy. The board may opt to receive only the statement of activity each month, rather than the full set of financials.

Board members should also be informed about cash balances, significant amounts due to the foundation, and any acquisition or disposal of property. You also need to be aware of any unusual amounts payable that could result in cash flow problems requiring board action.

WHAT IS THE BOARD'S RESPONSIBILITY TO THE FOUNDATION INVESTMENTS?

Community foundations are established to be a lasting influence on the community and a continual source of leadership and guidance throughout changing decades. To make certain that this will happen, the board must safeguard the foundation's assets.

Board members are legally required to make sure that the foundation's assets are managed prudently and productively. The standard of care that a corporate community board must exercise is set forth in most states in the Uniform Management of Institutional Funds Act (UMIFA) or a recently revised version of UMIFA, the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Under these acts, the board must exercise "ordinary business care and prudence" in making investment decisions, including whether to delegate such decisions to a committee, to foundation staff, or to independent advisors. The standard of care required for trustees of trust-form community foundations is similar, although expressed in a slightly different way. Under the Uniform Prudent Investor Act (UPIA) and similar laws adopted by most states, trustees must invest and manage trust assets as a "prudent investor" would do. Both UMIFA and UPIA permit boards to base investment decisions on the foundation's portfolio as a whole and to adopt an investment strategy that takes both risk and return into account (this is sometimes referred to as "total return" investing). These standards replace old laws that limited investments to certain approved categories or that required boards to completely avoid certain risky or speculative investments.

Federal tax law also plays a role in establishing board responsibility for investment decisions. This is particularly true for community foundations in trust form where a bank or other financial institution trustee makes investment decisions for trust assets. Federal tax law still requires the community foundation's board to regularly review the trustee's performance and to replace the trustee if he or she fails to achieve a reasonable rate of return over a reasonable period of time. The board may have the unilateral power to replace a trustee, but usually such action requires court approval.

In carrying out their responsibilities for oversight of foundation investment, boards should:

- develop written investment policies
- document the investment decision making process
- determine a reasonable amount to distribute for charitable purposes
- establish a return required to support the distribution target and seek an investment strategy that minimizes risk
- employ experts and delegate investment management if board and staff lack the expertise

WHAT KINDS OF RISKS DOES YOUR FOUNDATION FACE

Risk is any future event that might threaten your foundation's vital assets and compromise its ability to accomplish its mission. Generally, your assets fall into the following categories:

- people: board members, volunteers, employees, clients, donors, and the public
- property: buildings, facilities, equipment, materials, copyrights, and trademarks
- income: sales, grants, and contributions
- goodwill: reputation, stature in the community, and the ability to raise funds and appeal to prospective volunteers

One way to minimize exposure of these assets is to create a risk management program. Begin by determining why you need one—to reduce insurance costs or program-related staff injuries, for example. Next, establish an ad hoc risk management team to develop, recommend, and implement your risk management program. Because the plan must be integrated into all levels of the foundation, the team should work with operations staff and board members to identify risks and develop appropriate loss control and intervention strategies.

What Every Board Should Ask about Investment Oversight

- Do we have established investment objectives, including a timeframe, spending policy, acceptable rate of return, goals, and risk tolerance?
- Have we determined the asset allocation strategy, reviewing the risk and return history of asset categories, integrating recommendations from the investment committee, and ensuring that the strategy defines a process for moving and rebalancing assets when required?
- Has the board chosen a professional investment manager, someone who has a demonstrated track record of successful investment management, ideally with similarly sized or larger nonprofits?
- Is the manager's performance and adherence to policy regularly monitored?
- Have we supplied the investment manager with copies of our foundation code of ethics, mission, and objectives, and a written investment performance evaluation policy?
- Have we created and ensured implementation of an asset performance review process, using our previously approved asset allocation strategy or investment objectives as a guide?

WHAT IS D&O INSURANCE?

Risk management policies and procedures alone may not adequately protect your foundation or you against liability. Directors and officers (D&O) insurance helps protect board members and the foundation in the event of lawsuits. Some foundation indemnification policies, including a policy offered through the Council on Foundations, also pay legal costs for claims related to board service. A good D&O policy will also reimburse the foundation for indemnification expenses it may incur.

Negotiate for the best D&O policy for your organization (see page 25). Each foundation has specific needs that should be addressed and spelled out in the policy. It is a good idea to carefully check what is excluded as well as what is included. All the people you want covered should be listed in the policy—even volunteers, if applicable.

Understand the definition of covered losses. What is included? Attorneys' fees? Punitive damages? Penalties? Clarify the basis for payment of defense costs. Is it as incurred or as a reimbursement? Decide if you should extend the coverage to past acts, and calculate needed policy—limits and your deductibles. Finally, make sure you deal with an insurer who understands nonprofits.

NOTES

Section 7

How Does a Community Foundation Raise and Handle Funds?

WHAT IS THE BOARD'S ROLE IN RAISING FUNDS?

One of your jobs as a board member is to help build the foundation's assets. In order to do this well, you need to know the foundation's potential donors, the kinds of funds your foundation holds, the kinds of gifts that help build those funds, and your role in raising money. Building your foundation's assets is a joint venture between board and staff. Board members work with senior staff to design a long-range plan that has measurable financial and marketing goals. The board must also ensure that their development plan is tied to the foundation's strategic plan.

What does your foundation want to be in the future? Does it want to have a broad base of donors with high impact on individuals in the community? Then the foundation might have a plan/policy that encourages fairly small gifts. Are you in a rural area where much of the local wealth is in the form of property? Then your plan should accept gifts of real property.

Although development and fundraising is a partnership between board and foundation staff, the entire board has the ultimate responsibility for the foundation's financial resources. This means the board can't pass the need to find the assets to anyone else.

WHAT IS THE DEVELOPMENT COMMITTEE'S ROLE?

Much of the foundation's asset building is done through a development or advancement committee, whose primary role is to advise the foundation board and staff on all matters pertaining to fund development, including policy development and review and strategic planning. They oversee the development plan, carry out specific fundraising activities, communicate with individual board members about their fundraising responsibilities, and work with management to ensure that the development tasks allocated to the board are completed.

The Importance of a Development Plan

A development plan is a prioritized and systematic roadmap of how to achieve the foundation's fundraising objective.

A good plan includes:

- measurable objectives, such as benchmark figures for major and planned gifts over a multi-year period
- a work plan with staff responsibilities to meet these goals
- clearly assigned volunteer responsibilities

Specific development committee responsibilities often include:

- developing and modifying policies regarding the acceptance of gifts or the creation of funds
- making recommendations when proposed gifts do not comply with the foundation's policies
- considering strategies to build the foundation's endowment

WHO GIVES TO A COMMUNITY FOUNDATION?

A community foundation's assets are developed through a variety of sources. Gifts, grants, and other kinds of funds are built with the help of many entities. Together, they build a diverse asset base of various funds that serve the charitable goals. The scope of givers includes:

- **Families and individual donors** who bring with them varying giving practices, such as large gifts over time or one-time gifts. A family may have a private foundation but also want to make bequests or set up a donor-advised fund.
- **Charitable organizations** that place their own endowment funds with the community foundation for management and investment.
- **Businesses** that give through pledges or funds related to or of interest to the industry
- **Private foundations** that match other gifts, make challenge gifts, make grants to the community foundation endowment or operations, or join with the community foundation to fund projects of mutual interest.
- **Government entities** that set up funds or make grants to the foundation to meet a civic need. It is also typical practice that every board member from the community foundation makes some kind of financial gift. Expectations are generally laid out when a person first joins the board.

WHY DO DONORS GIVE TO A COMMUNITY FOUNDATION?

Giving to a community foundation helps donors of all types achieve their charitable and financial goals by providing tools and resources that make giving easy, flexible, and effective. Community foundations provide:

- **Local expertise:** They have an in-depth understanding of the community's challenges and the groups and individuals addressing them.
- **Community leadership:** They play a key role in addressing community needs, now and in the future.
- **Personalized service:** They help individuals, families, businesses, and nonprofit agencies achieve their charitable and financial goals by providing tools and resources that make giving easy, flexible, and effective.

Fund Types

Unrestricted (or general purpose) funds: Also called discretionary funds, these funds offer the most flexibility to the community foundation because they give the discretion to use these funds to serve the changing needs of the community.

Field-of-interest funds: Rather than direct grants to a single organization at the time the fund is created, the donor specifies interest in a particular program area such as education, health, or the environment.

Donor-advised funds: The donor, or a committee appointed by the donor, may recommend eligible recipients for grants from the fund.

Designated funds: At the time the fund is created, the donor directs the fund's annual payout to one or more specific charitable organizations.

Agency endowments: Local charities may give their endowment funds to charitable community foundations. The community foundation then holds the fund for the benefit of charity.

Scholarships: These funds are used to provide support for individuals for higher education, research, travel, or other kinds of training.

Also, although all grantmaking organizations are required legally to provide due diligence (a reasonable amount of oversight to assure that grants are being used appropriately), community foundations excel in this area. Part of the mission of a community foundation includes doing what is best for the community, even if it requires solutions beyond simply providing funding. Most have staff and resources dedicated to investigating broad and creative solutions to community problems. Because of these resources, community foundations offer donors and grant seekers more options for addressing community problems.

The community foundation also offers donors a number of ways to satisfy their charitable interests, including setting up one or many types of funds. To help cultivate and encourage its donors, your community foundation may offer them services such as donor orientation and ongoing education about community needs, confidentiality policies, and systems to record and receive gifts. It is also a good idea to publicly recognize donors whenever possible by featuring them in the foundation's annual reports, webpages, and newsletters. Asking donors to participate in tours, conduct donor satisfaction surveys, or convene groups of other donors at events such as lunches or alumni societies are additional ways to let them know how much their contributions are appreciated and valued.

An effective marketing plan illustrates to donors the value and impact of a gift to the community foundation. Although your foundation staff may develop a marketing strategy and work to provide strong donor services, your board oversight and guidance is vital in setting the overall direction and practices.

Donor-initiated Fundraising

Foundations that permit donors to conduct fund-raising activities should pay particular attention to compliance with federal and state requirements. See Appendix 3 for more resource information.

What Are Planned Gifts?

Planned gifts are made when the donor decides during his or her lifetime to make a gift, but the foundation doesn't get full use of the asset until a later date (usually after the donor's death).

There are two kinds of planned gifts—those in which the donor receives no life income, such as wills and life insurance, and those that give the donor life income, such as charitable gift annuities, remainder trusts, or pooled income funds.

HOW DO COMMUNITY FOUNDATIONS DECIDE WHAT GIFTS TO ACCEPT?

Donors can make gifts in a variety of ways, and community foundations excel in their ability to accept a wide range of gifts.

Typical gifts include:

- cash
- appreciated securities
- life insurance
- real estate
- closely held securities, e.g., ownership interests in small businesses
- personal property, e.g., artwork, automobiles, livestock, jewelry
- retirement assets, e.g., 401(k)s, IRAs, pension funds
- wills and bequests
- charitable trusts, e.g., charitable lead trusts, charitable remainder trusts
- planned gifts

Material Restriction

A material restriction is any condition imposed by a donor that prevents a community foundation from freely and effectively employing contributed assets or the investment return on those assets to further the community foundation's exempt purpose.

It is sound practice for foundations to have gift acceptance policies to protect the foundation from accepting gifts that may turn out to be costly to the foundation or present legal, logistical, or operational problems. Good policies also ensure that fundraising fits the foundation's mission and will help prevent the embarrassment of accepting an inappropriate gift.

WHAT HAPPENS AFTER SOMEONE MAKES A GIFT?

Once a gift has been made to a community foundation, the donor may have some say in how the funds are used, but they no longer have absolute authority over the funds. Although a donor can offer advice or recommendations to the foundation, once the gift is complete a donor cannot control when or to whom charitable distributions are made, or with whom the funds are invested.

According to the IRS, deciding whether or not a donor actually has retained control requires scrutinizing all the facts and circumstances surrounding the gift, as well as its subsequent charitable distributions. To determine whether excessive donor control is present, the IRS applies either directly or by analogy tests that are set forth in the material restriction rules.

Remember that once a donor makes a gift to the community foundation, the donor no longer owns it. The donor can name the fund, decide if it is to be endowed or passed-through, specify a charity as beneficiary, and designate a purpose for which the gift can be used. However, the donor cannot wait to choose a recipient, control the timing of the distribution, require that a particular financial advisor irrevocably manage a gift, or require the foundation to hold assets (except if the asset is used directly in a charitable activity). Donors can make recommendations, but they are subject to the approval of the foundation board of directors.

CAN COMMUNITY FOUNDATIONS EVER REMOVE DONOR RESTRICTIONS?

If, over time, a restriction on a gift no longer makes sense, there are a number of ways a community foundation might be able to remove donor restrictions.

First, a donor may agree to the change. The Uniform Management of Institutional Funds Act (UMIFA), enacted in most states, permits donors to consent to the removal of a donor restriction. Consult counsel on whether UMIFA, or a recently revised version of UMIFA, the Uniform Prudent Management of Institutional Funds Act, has been adopted in your state and whether, as adopted, the donor may release restrictions.

Second, the foundation may exercise its variance power. All community foundations are required to have this power that specifically allows the board to modify any restriction or condition on funds. Typically, this power is described in the foundation bylaws, although it may also appear in articles of incorporation or trust agreements or in the fund agreements themselves. Examples of when a community foundation might exercise its variance power include when:

- a charity designated by the donor has ceased to exist
- a fund's purpose no longer makes sense
- a charity designated by the donor has become seriously dysfunctional or has significantly changed its original mission and purpose

Because any attempt to alter donor restrictions can be controversial, it should be exercised with caution and only if the board feels that it is justified under the circumstances. As always, consultation with legal counsel is advisable.

Third, the foundation may remove restrictions through court action. UMIFA permits courts to remove donor restrictions if the restriction has become "obsolete, inappropriate, or impracticable." However, a court may not change an endowment fund into one that is not endowed. Notice of a proposed change must be given to the state's attorney general. Normally, the variance power that the donor grants to the community foundation should make it unnecessary to seek court approval to remove a restriction.

What is Variance Power?

Variance power allows a community foundation to remove or modify a donor restriction if it becomes unnecessary, is incapable of fulfillment, or is no longer in the best interest of the community. The National Standards for Community Foundations, which can be found in Appendix 1, mention variance power directly in Standards II.E and IV.C and indirectly in Standards III.B and IV.E. Variance power is specifically identified as a key element for two documents: Document 1: Governing Instruments; and Document 22: Sample Fund Agreements.

Under the community trust rules in the tax regulations, a fund will not be considered a component of a community foundation unless, among other things, the governing body has the power to “modify any restriction or condition on the distribution of funds for any specified charitable purpose or to any specified organization if, in the sole judgment of the governing body, such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served.” Furthermore, the governing body must be able to modify the restriction without obtaining the approval of any participating trustee, custodian, or agent of the community foundation. (*Legal Compendium for Community Foundations*, Christopher R. Hoyt, Council on Foundations, 1996.)

Although the community trust rules only apply explicitly to community foundations created in the trust form, they have also been applied to assets held by community foundations organized in corporate form. Therefore, for a restricted fund to be considered a fund of the community foundation, and not a separate private foundation, the governing board must possess the variance power with respect to that fund. Under IRS rules, the authority to exercise the variance power may be granted in either the governing documents, board resolution, or the fund agreement. However, because a community foundation may have little or no opportunity to negotiate the terms of the gift instrument for testamentary gifts, variance power language *must* appear in the governing documents to ensure that the governing board possesses the variance power for all funds.

Section 8

How Do Community Foundations Conduct Grantmaking?

The ability to award grants drives community foundations and is the end result of the fundraising, investment, and community study that came before it. Grants touch people. They make a difference in the community. Grants that positively impact the community are one of the true measures of a successful community foundation.

WHAT ARE THE BOARD'S AND THE STAFF'S ROLES IN GRANTMAKING?

Nearly all community foundations have staff that oversee the application process, work directly with potential grantees to complete grant applications, conduct site visits, or otherwise follow up to gather in-depth information about potential organization or program grants. Staff members also recommend applicants to the board or board committee for approval.

Part of the board's role is to set the parameters within which the staff operates. Defining strategies is an essential part of the task. For example, the board may help to decide the extent to which the foundation should be responsive and proactive (publishing guidelines and soliciting grantees) or influential (getting directly involved in creating change by partnering with grantees).

The board also helps to develop a clear vision of how the foundation's grants fulfill its purpose and whether or not they align with the intent of donors and the foundation's mission. Setting policies that direct how the foundation implements the grantmaking process helps the board guarantee the integrity of the grantmaking process.

What Kinds of Grants Do Community Foundations Make?

Your foundation may make grants that serve a variety of purposes. Some typical grant options are:

- **Project support:** A project grant supports a prescribed set of activities to achieve a defined project outcome.
- **Seed grants:** These support new organizations or programs. The grantee can use the funds for planning, feasibility studies, or initial staff and operating costs.
- **Research or planning grants:** Research and planning grants give organizations or individuals time, support, and leverage to plan for and gather information on a specific project.
- **Matching or challenge grants:** With these, your foundation pledges to match the amount an organization can raise from other sources. The match ratio may be 1:1 or greater.
- **General (unrestricted) or operating support:** These grants can be used for the full range of grantee activities, including operating expenses and overhead.
- **Capital grants:** These support land purchases, facility construction and renovation, and similar activities.

The level of direct board involvement varies with the size and development stage of your foundation. Some boards believe that the entire board should oversee the foundation's grantmaking. Others have a board committee (often called the program, distribution, or grants committee) that works with the staff to vet and recommend grants before they are brought to the full board for final review and approval.

WHAT IS THE GRANTS OR PROGRAM COMMITTEE'S ROLE?

This committee is composed of board members who are familiar with the community, best represent different aspects of that community, and understand the approaches and operations of the foundation's policies.

Usually, this committee:

- works with staff to develop a grantmaking plan consistent with the foundation's mission and vision
- reviews program focus areas and, based on community needs, recommends revisions to the entire board
- attends site visits—planned visits to potential grantees and their organizations—to learn about the nonprofits that the foundation funds
- reviews grant proposals and authorizes funding based on the proposal's merits, available funding, and foundation priorities
- monitors compliance with donor restrictions on specific named funds
- helps set the grantmaking budget
- reviews the outcome of grants and the effectiveness of the programs the foundation supports

HOW DOES THE GRANTMAKING PROCESS WORK?

A successful grant process begins with clear communication. Brochures, web-based information, printed grant guidelines, newsletters, and annual reports all help to tell your story and should help a potential grantee understand your grantmaking criteria.

Grant guidelines should detail the kinds of grants your foundation makes, as well as those it doesn't, and should clearly describe your foundation's application process and requirements. Your foundation probably has a set grant cycle—probably making two to four grants a year—and a specific time during which an organization can submit a grant proposal for review, approval, and funding. Deadlines should be clearly stated within the guidelines.

What Do Foundations Look for in Grant Proposals?

- **Importance:** Should this project be done? Is it significant? Is there evidence that the project will trigger action or work that the community wants? Given your other funding opportunities, is this one worthy of support at this time?
- **Credibility:** Does the applicant organization know what it wants to accomplish? Is there evidence that it is currently achieving its goals? What kind of reputation does the organization enjoy within its community and beyond?
- **Capability:** What skills do the organization's staff and board have? Has the organization succeeded in similar endeavors of equal scale?
- **Feasibility:** Can the project get done? Has the organization allotted enough time and money?

Some foundations ask grantees to submit a letter of proposal that outlines their request before submitting a full proposal. Others accept unsolicited proposals. Once received, the proposals are usually first reviewed by foundation staff to ensure that they are complete and clear. Staff members, sometimes working with members of the grants committee, then write a summary document that accompanies the proposal to the grants committee or directly to the board. These summaries evaluate the project and include a recommendation to fund or not to fund.

Once the grants committee or board reviews the proposals and approves those believed to fit within the foundation's mission, purpose, and grantmaking objectives, staff members notify applicants about whether or not they received funding. From then on, working more or less closely with board members, program staff monitors and evaluates the progress of the grants and oversees the closing out of projects, including submission of final reports to the foundation.

HOW DOES OUR FOUNDATION EVALUATE GRANTEES?

Your foundation may rely on interim reports and informal staff project reviews by staff and board members to monitor the progress of a grant. In addition, most foundations ask grantees to submit final reports that assess their project's success or failure. A final project report usually explains what was accomplished, noting any challenges and how they were dealt with. The report might detail what lessons, if any, the grantee learned during the project, and how the foundation's grant may have changed the organization.

Many community foundations support external evaluation of their grants in an effort to track community impact and the value of the grants they make. A foundation may evaluate a project or a series of similar projects in depth or might ask an outside evaluator to evaluate a project. This provides an independent, objective, external look at the project and its accomplishments.

Another method is the cluster evaluation, which looks at a number of grants at the same time. Cluster evaluations may include projects with the same strategies focusing on different outcomes, projects with different strategies focusing on the same outcomes, or projects that illuminate separate pieces of a larger picture. Cluster evaluations vary depending on the situation and may include external, self-designed, or foundation-developed evaluations. Typically, the projects in the cluster use common definitions and measurements to make it possible to compare the strategies and outcomes from each project.

NOTES

Where To Find More Information

LEARNING THE LANGUAGE

We hope that this guide has helped you better understand how a community foundation works, what a community foundation is, how it raises and handles funds, and how it conducts its grantmaking. We also hope it helped illustrate good board practice, including how boards are structured, what typical committees do, and the fiduciary and legal responsibilities of both an individual board member and the board as an entity—in short, how the work gets done.

While we hope this guide serves as a good introduction, it will likely inspire further questions. We have attached a basic glossary to help you master the language and a list of additional resources.

WHAT ARE THE U.S. STANDARDS FOR COMMUNITY FOUNDATIONS?

Veteran community foundation board and staff developed the National Standards for U.S. Community Foundations, along with compliance indicators. These documents lay out the field's minimum practices as a guide to sound policies and accountable practices. Community foundations use these standards to build their capacity and to establish the highest levels of ethical and operational integrity. A copy of the standards is attached.

BEYOND THE LOCAL

With over 650 community foundations across the United States, you are part of a greater field. Consider serving as an elected member of the **Community Foundations Leadership Team** at the Council on Foundations. This volunteer leadership group sets national priorities and creates the programs to carry them out. Add your voice to the ongoing national dialogue.

If you have questions, feel free to contact the Governing Board Programs department at the Council on Foundations at 202/466-6512, or BoardSource at 800/883-6262.

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Appendix 1

National Standards for U.S. Community Foundations

WHY NATIONAL STANDARDS?

In the United States, community foundations serve tens of thousands of donors, administer more than \$31 billion in charitable funds, and address the core concerns of nearly 700 communities and regions. With such a presence—nationally and within local communities—comes responsibility. National Standards for U.S. Community Foundations are an individual and collective commitment and an outward sign that community foundations take this responsibility very seriously. Below is an articulation of the reasons National Standards were developed and the reasons community foundations across the country are committing themselves to achieving these standards.

NATIONAL STANDARDS GUIDE SOUND POLICIES AND ACCOUNTABLE PRACTICES

Community foundations of all sizes use National Standards as a roadmap to establish legal, ethical, and effective practices that withstand the scrutiny of donors, government, and media. National Standards can be used to publicly communicate community foundations' commitment to accountability, excellence, and service. Over time, the National Standards have become an important framework for the organizational development of community foundations. With National Standards, organizations can certify their status as a "community foundation," and reaffirm their capability in delivering comprehensive services.

With National Standards as a base, community foundations establish high levels of ethical and operational integrity, separating themselves from the potential wrongdoing or mistakes of other entities. Community foundations also use National Standards to promote self-regulation in a manner viewed positively by the Internal Revenue Service, which has increased its scrutiny of charities, especially those offering donor-advised funds.

NATIONAL STANDARDS BUILD CAPACITY TO CARRY OUT MISSIONS

National Standards set consistent expectations among community foundation boards and practitioners, lending focus and saving time. They also provide a framework for documenting, communicating, and providing training and technical assistance to advance best practices.

NATIONAL STANDARDS MAKE COMMUNITY FOUNDATIONS DISTINCTIVE

Community foundations use National Standards to distinguish themselves from a variety of competitors that offer traditional community foundation services, such as donor-advised funds, in a marketplace that is both local and national. As a field, community foundations engage in collective marketing, pooling resources and co-branding themselves to build awareness of the field for individual community foundation benefit. National Standards reduce the risk of joint marketing by ensuring all participants have met benchmarks for quality in operations and service.

NATIONAL STANDARDS FOR U.S. COMMUNITY FOUNDATIONS

(As approved by the Community Foundations Leadership Team on June 8, 2000, and including explanatory language as of February 28, 2002, and a technical correction as of March 24, 2004)

I. Definition of a U.S. Community Foundation

- A. A community foundation is a tax-exempt, nonprofit, autonomous, publicly supported, nonsectarian philanthropic institution with a long-term goal of building permanent, named component funds established by many separate donors for the broad-based charitable benefit of the residents of a defined geographic area, typically no larger than a state.

Community foundations are further defined by the following characteristics:

II. Mission, Structure, and Governance

- A. A community foundation is founded and operated for public benefit and has a well-defined, articulated mission.
- B. A community foundation is recognized by the Internal Revenue Service (IRS) as tax-exempt under Internal Revenue Code Section 501(c)(3), organized and operated exclusively for charitable purposes.
- C. A community foundation meets the public support test set forth in Internal Revenue Code Section 170(b)(1)(A)(vi) as modified by Treasury Regulation Section 170A-9(e)(10).
- D. A community foundation has an independent governing body broadly representative of the community it serves.

Explanation: "Governing body" means the board of directors or board of trustees of the organization. "Broadly representative" means that the governing body reflects the diverse composition and different perspectives of the community it serves, and that its members are not drawn solely from a single subset of the community.

- E. A community foundation's governing body retains variance power by which it may modify any restriction or condition on the distribution of assets, if circumstances warrant. Further, with respect to assets held in trust, the governing body must have the power to replace any participating trustee for breach of fiduciary duty under state law or for failure to produce a reasonable return of net income.

Explanation: "The governing body must have the power to modify any restriction or condition on the distribution of funds for any specified charitable purpose or to any specified organization if, in the sole judgment of the governing body, such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served. The governing body must be able to modify the restriction without obtaining the approval of any participating trustee, custodian, or agent of the community foundation." (Legal Compendium for Community Foundations, Christopher R. Hoyt, Council on Foundations, 1996)

For those community foundations with assets held in trust, the governing body must also have the authority to remove the trustee responsible for those assets in at least two circumstances. This power of removal must be available if the trustee breaches its fiduciary duty or if the trustee fails to produce a reasonable return on investments. The governing body of a corporation normally has the power to remove asset managers, so the power need not be separately articulated in the governing instruments of the corporation. However, provisions in gift agreements that attempt to restrict this power would be material restrictions and should not be accepted by a community foundation.

- F. A community foundation serves a particular geographic area such as a municipality, county, state, metropolitan area, or closely related aggregation of such areas that are considered for some purposes as a community, typically no larger than one state. An organization serving a single greater metropolitan area would satisfy this criterion even if that greater metropolitan area included parts of several states. This criterion excludes national and multi-national organizations.

Explanation: Service to a particular geographic area typically includes grantmaking, community leadership, and service to donors in that identified area. Unrestricted/discretionary funds primarily serve the community foundation's identified geographic area; other grants may be distributed beyond that area.

- G. A community foundation's governing body:

1. is responsible for the mission, direction and policies of the organization.

Explanation: The governing body of the community foundation is the ultimate fiduciary and is legally accountable for all of the activities of the organization, even when it delegates responsibility.

2. ensures adequate human and financial resources and actively monitors and evaluates the organization's chief executive officer.

Explanation: Human resources may include paid or unpaid staff. It is the responsibility of the governing body to provide adequate resources to meet the National Standards.

3. approves policies to prevent perceived, potential, or actual conflicts of interest.
4. serves without compensation (exclusive of the chief executive officer).
5. is not controlled by any other nonprofit organization, or by any single family, business or governmental entity, or any narrow group within the community.
6. reviews and adopts an annual operating budget.
7. ensures that the governing documents include policies for size of the board, required number of meetings annually, limits of members' terms, and structure and responsibilities of standing committees.
8. ensures that the community foundation reflects the diversity of the community it serves.

Explanation: This item correlates to the item above regarding the governing body membership reflecting the community. Here, the governing body is looking beyond itself and seeking staff and committee diversity, policies that do not promote exclusivity, and endeavors that address diverse communities.

9. ensures that the community foundation meets all laws and legal requirements.

Explanation: All applicable local, state, and federal laws and regulations must be observed.

10. approves all grants.

Explanation: The governing body has responsibility for grant approval, which may be exercised through delegation of the decision making process.

III. Resource Development

- A. A community foundation has, or works to develop, broad support in the form of contributions from many separate, unrelated donors with diverse charitable interests in the community served by the community foundation.
- B. Contributions to a community foundation represent irrevocable gifts subject to the legal and fiduciary control of the community foundation's governing body.
- C. A community foundation has a long-term goal of securing resources to address the changing needs of the community it serves.

Explanation: Building discretionary funds to provide both flexible and permanent funding sources for meeting changing needs should be a goal of the community foundation.

- D. A community foundation accepts and administers a diversity of gift and fund types to meet the varied philanthropic objectives of donors.
- E. A community foundation adopts gift and fund acceptance policies that address minimum fund size, types of fund options, types of gift mechanisms, and policies and procedures for accepting various types of assets, and makes these policies available upon request.

Explanation: This item promotes accountability, policy and process disclosure, and consistency. Fund acceptance policies include purpose and use of the fund.

- F. During the gift planning process, the role and relationships of all parties involved are fully disclosed to the donor.

Explanation: The intent is to disclose any financial benefit that might accrue to a third-party participant in the gift planning process.

IV. Stewardship and Accountability

- A. A community foundation is a steward of charitable funds, investing and prudently managing funds, and maintaining accurate financial records.
- B. A community foundation is accountable to the community it serves and regularly disseminates information on its programs and finances.
- C. A community foundation maintains a written record of the terms and conditions of each component fund and all such records must reference the variance power.
- D. A community foundation honors the charitable intentions of its donors consistent with community needs and applicable laws and regulations.
- E. A community foundation observes the balance between donor involvement and governing board control and complies with applicable laws and regulations.

- F. A community foundation ensures that the foundation's financial resources are used solely in furtherance of its mission.

Explanation: Some examples of intent here include 1) salaries and benefits are within a range considered reasonable and customary for community foundations of similar size and taking into account the background and experience of staff, and 2) assets of the foundation are not used for personal benefit of either board or staff.

- G. An annual audit (financial review when assets total less than \$1 million) is performed by an independent public accountant, reviewed and accepted by the governing body, and made available to the public upon request.
- H. A community foundation:
1. has investment policies that include asset allocation guidelines, a spending policy, and criteria for measuring investment performance.
 2. makes available to the public upon request the names of its investment managers, fees charged (including investment and administrative fees), and governing body or appointees responsible for investment oversight and investment.

V. Grantmaking and Community Leadership

- A. A community foundation operates a broad grants program to multiple grantees that is limited neither by a single focus or cause nor exclusively to the interests of a particular constituency.
- B. A community foundation awards some grants from its discretionary resources through open, competitive processes that address the changing needs of the community.
- C. A community foundation widely disseminates grant guidelines to ensure the fullest possible participation from the community it serves.
- D. A community foundation performs due diligence to ensure that grants will be used for charitable purposes.
- Explanation: Due diligence applies to all grants made by the foundation and includes gathering and evaluation of information on the grantee and may include the intended use of the grant. Vigilance regarding quid pro quo benefit to a donor advisor would fall within the scope of this item.*
- E. A community foundation works to identify community issues and opportunities and acts as a leader and convener, using its human and/or financial resources to address immediate and long-term community issues and opportunities.

VI. Donor Relations

- A. A community foundation informs and educates donors about community issues and grantmaking opportunities.
- B. A community foundation actively involves donors in identifying and responding to community issues and opportunities.
- C. A community foundation promptly and accurately acknowledges gifts.
- D. A community foundation provides fund statements, at least annually, to those donors who wish to receive them.

- E. All private information obtained with respect to donors and prospects is kept confidential to the fullest extent possible.

VII. Communications

- A. A community foundation communicates openly and welcomes public scrutiny.
- B. A community foundation has a communication strategy that includes a report, widely distributed at least annually, that describes the community foundation's mission, activities and financial operations.

Appendix 2

Conflicts of Interest at Foundations: Avoiding the Bad and Managing the Good

Produced with support from the Forum of Regional Associations of Grantmakers and the Council of Michigan Foundations, July 2005.

INTRODUCTION

Foundations seek active and engaged individuals to serve on their boards because they bring expertise, talents, and a commitment to the communities served by the foundation. Such individuals often face challenges in carrying out their board responsibilities; the number and variety of connections they have make it likely that they will face situations that involve multiple loyalties. Making unbiased, independent decisions on behalf of a foundation can be difficult when a colleague, a friend, a family member, or a business relationship may be affected by, or benefit from, those decisions.

Multiple loyalties can create conflicts of interest. In private foundations, conflicts of interest occur when the financial or personal interests of board members or foundation managers are, or appear to be, inconsistent with the interests of the foundation.

These situations arise, for example, when a foundation wants to hire a board member's company to provide investment advice, lease space in an office building owned by the family of a board member, or increase board compensation for the first time in many years.

In some cases, conflict-of-interest transactions violate the law; in other situations, they work to a foundation's advantage. Regardless of intention or result, however, foundations, their boards, and their managers must act very carefully when dealing with transactions that are, or appear to be, inconsistent with a foundation's interest, for several reasons.

Conflict-of-interest transactions can create substantial legal liability, especially if they violate the self-dealing prohibitions under the federal tax laws. In those situations, board members and foundation managers can be personally liable because they engaged in the transactions, approved them, or both.

Conflicts of interest carry risks of negative public perception. As charitable institutions provided with special tax status, foundations are expected to serve the public trust. When they engage in improper transactions—or those that give the appearance of impropriety—the damage can extend beyond their good name and reputation to the charitable sector as a whole.

Conflicts can compromise the decision-making process, preventing board members and foundation managers from having open and candid discussions and, in some cases, from acting in the best interests of the foundation.

The following discussion will guide board members and foundation managers in defining conflicts of interest, identifying which transactions are absolutely prohibited and which are permissible if properly handled, and developing a conflict-of-interest policy that protects foundations, board members, and foundation managers by taking self-interest out of the decision-making process. Additionally, a sample conflict-of-interest policy and disclosure questionnaire for foundations is provided.

For foundations, the bottom line is this: Conflicts of interest should either be avoided or managed in such a way that the foundation and its board and managers are protected from liability or unwelcome publicity. By answering the following five questions and by following the processes recommended in this paper, foundations can minimize legal risks, protect themselves and their board members and foundation managers against bad publicity, and most important of all, ensure the integrity of their decision-making process. The five questions are:

1. Is this transaction a conflict of interest or could it be perceived as such by others?
2. Is it prohibited by the self-dealing rules under the Internal Revenue Code?
3. Even if the transaction is not prohibited by the self-dealing rules, is it unfair to the foundation? i.e., does it improperly benefit another person or organization?
4. Does the transaction create an appearance problem? How would it look on the front page of tomorrow's newspaper or to the foundation's founders?
5. Has the foundation followed its conflict-of-interest policy and documented that fact?

This paper outlines the law and the factors that should be considered when answering these questions. It also includes examples of situations that foundations regularly encounter to offer the reader an opportunity to "test" his or her understanding.

IS THIS A CONFLICT OF INTEREST?

The starting point for managing conflicts of interest is to know when they exist.

A conflict of interest arises whenever the "financial or personal interests" of a board member or foundation manager are, or appear to be, inconsistent or at odds with the interests of the foundation.

Most foundation conflicts of interest arise in the context of proposed transactions with parties that fall in the following general categories:

- board members and foundation managers
- family members of board members and foundation managers
- organizations in which board members, foundation managers, or their family members have a significant financial relationship
- organizations in which a board member, foundation manager, or family member is an officer, director, trustee, or employee

Applying those categories, foundations can find themselves facing conflicts of interest when they propose to take actions such as engaging a board member's law firm for professional services, hiring the president's spouse as a program officer, selling foundation property to a board member's grandchild, or making grants to a charity run by a board member's child.

Some transactions that involve conflicts of interest are **absolutely prohibited by law**. Those transactions are described in the tax code and are known as the self-dealing prohibitions. Others do not involve activities that are prohibited by the self-dealing rules, but they are conflicts nevertheless and therefore require careful consideration in a process designed to show the fairness and integrity of the decision to enter into them.

IS THE TRANSACTION PROHIBITED BY THE SELF-DEALING RULES?

The most dangerous conflicts of interest for foundations involve transactions that violate the self-dealing rules of the Internal Revenue Code.¹ These rules prohibit private foundations from engaging in certain transactions (called “acts of self-dealing”) with board members, foundation managers, and certain of their family members and affiliated organizations (called “disqualified persons”²).

Disqualified persons who engage in acts of self-dealing are subject to excise tax penalties and are also required to correct the improper transactions by making payments back to the foundation. Board members and foundation managers who knowingly approve acts of self-dealing are also subject to an excise tax. Repeated and willful violations of the self-dealing rules may cause a foundation to lose its tax exemption.

The self-dealing rules absolutely prohibit most transactions between foundations and their board members and foundation managers (and certain family members and affiliated companies), without regard to whether the transactions are fair—or even advantageous—to the foundations.

Some, but not all, of the activities that are prohibited by the self-dealing rules are:

- buying and selling property from or to disqualified persons, even on terms that are favorable to the foundation
- renting property to disqualified persons, or leasing property from disqualified persons except on a rent-free basis
- lending money to disqualified persons, or borrowing money from disqualified persons except on an interest-free basis
- allowing disqualified persons to use a foundation’s income or assets, except for goods or services that are furnished to them on the same terms as other members of the public

The self-dealing rules carve out an important exception that allows foundations to pay disqualified persons reasonable compensation for personal services.³ This is by far the most common conflict-of-interest situation for foundations, and it was a hot issue for congressional committees, the IRS, and state attorneys general in 2004 and 2005. It is critical for foundations to take the right steps to ensure that any compensation paid to disqualified persons, including board members and foundation managers, is reasonable.

The IRS has outlined the proper process for determining nonprofit compensation as part of the relatively new intermediate sanctions rules governing public charities. These rules establish three criteria for determining compensation that, if followed, will avoid any conflict of interest and create a presumption that the compensation

¹ Section 4941 of the Internal Revenue Code.

² “Disqualified persons” are defined under Section 4946 to include board members, foundation managers, and persons who have made substantial contributions to the foundation (more than the greater of \$5,000 or 2 percent of total contributions); owners of more than 20 percent of a corporation, partnership, or trust that has made substantial contributions; corporations, partnerships, trusts, or estates in which the persons named above own more than a 35 percent interest; and senior government officials. The term also includes family members of the persons named above, but only their spouse, ancestors, and children, grandchildren, great-grandchildren, and their spouses; it does not include siblings, nieces and nephews, aunts and uncles, cousins, or other more distant relatives. The term does not include other Section 501(c)(3) organizations.

³ For purposes of the self-dealing rules, the “personal services” exception applies to services of employees who work for a foundation, services of board members, and professional services such as for legal, accounting, investment management, and trustee services.

paid is reasonable.⁴ While these rules do not apply to private foundations, they do provide guidance as to the appropriate compensation approval process. They are as follows:

1. Compensation decisions should be made by an independent board or an independent committee of the board.
2. The board or board committee should obtain and rely on market data regarding compensation paid by similar organizations for similar services.
3. The board or board committee should contemporaneously document the basis for the compensation decision, including the decision made and the market data relied on to establish reasonableness, in its minutes.

In some cases, it is not possible to follow the first step in this process because there are no independent members of the board. Board members cannot, for example, follow the first step when they set their own compensation. Similarly, family foundations may not have any outside board members who are independent of the family members whose compensation is under consideration. Where the first step cannot be met because there is no disinterested decision maker, it is even more important for the board to follow the second step—to obtain and rely on market data showing the reasonableness of the compensation. In some cases, boards may want to consider obtaining an opinion as to reasonableness from an independent compensation consultant. This can be helpful if the foundation is later audited by the IRS. It will also help protect board members from any liability for knowingly paying excessive compensation.

As mentioned above, even if the activity does not violate the prohibition against self-dealing, it may be a conflict of interest that carries other risks to the foundation and its board members and foundation managers. As such, it should be flagged and handled properly to prevent liability or adverse publicity.

IS THE TRANSACTION FAIR TO THE FOUNDATION?

Foundations must also be careful not to engage in conflict-of-interest transactions on terms that are unfair to the foundation. This is a separate legal violation—a breach of the fiduciary duties owed to foundations by their board members and foundation managers. As fiduciaries, board members and foundation managers are required to act in the best interest of the foundation and not to engage in transactions that further their own interests at the foundation's expense.

Board members and foundation managers can be personally liable for any damage or loss to the foundation resulting from a breach of their fiduciary duties. Most states have officials in the office of the state attorney general who are charged with taking enforcement action—in some cases including lawsuits seeking money damages—against persons who breach their fiduciary duties to charitable organizations. These state officials have investigative powers similar to those of the IRS and will actively pursue allegations that board members or foundation managers have engaged in conflict-of-interest transactions that take unfair advantage of the foundations to which they owe fiduciary duties.

⁴ Treas. Reg. 53.4958-6(a).

DOES THE TRANSACTION CREATE AN APPEARANCE PROBLEM?

Some transactions create an appearance of a conflict of interest, risking public perception that can damage the reputation of a foundation or its board and management. To understand the kind of negative impact they can cause, imagine headlines like these:

- Corporate Foundation Pays for Employees to Attend Charity Gala
- Foundation Trustees Steer Contracts to Family Members
- Local Foundation Grant Funds Jobs for Children of Trustees
- Foundation Pays Millions in Executive Retirement

Even where nothing untoward has occurred, foundations are exposed to headlines like these when they engage in transactions that create an appearance of a conflict of interest. To reduce the risk of negative perception and publicity, foundations should be sensitive to the issue of public perception, factor that into the decision-making process, and follow a conflict-management process such as that described below. For family foundations, issues of public perception may be particularly acute since there may be no independent board members to help counterbalance the perception of family self-interest. In some cases, foundations may find it helpful to factor the philosophies of their original founders into their decision-making process, given that a marked deviation from the founders' wishes may itself raise issues of public perception.

Some appearances of conflict may occur because the foundation is involved with a transaction in which a foundation board member or manager is also associated with another organization but is able to act in a manner consistent with the best interests of both organizations. These are transactions that are more properly characterized as dualities of interest. Examples include situations in which foundation board members are also trustees of charitable organizations that receive foundation grants or transactions between a foundation and a company that employs a board member or his/her spouse. While the financial or personal interest of the board member in these cases may be negligible, these are the kinds of transactions that raise questions about whether decisions have been unduly and inappropriately influenced by close relationships. For this reason, foundations should protect themselves by including these transactions within the scope of their conflict-of-interest policies.

HAS THE FOUNDATION FOLLOWED ITS CONFLICT-OF-INTEREST POLICIES AND PROCESSES?

For many foundations, particularly family foundations, conflicts of interest can be unavoidable. To ensure that the foundation, its board, and its managers do not engage in illegal or risky decisions, the board should:

1. Adopt a written conflict-of-interest policy, which includes, at a minimum, the following provisions:
 - a statement of who the policy applies to (typically board members and foundation managers)
 - a definition of what constitutes a conflict of interest (including to which family members⁵ and affiliated entities the policy applies)

⁵ There is no precise definition as to which family members should be covered in a conflict-of-interest policy. The self-dealing rules are generally considered to be too narrow since they exclude siblings. However, some extended family relationships may be too remote to raise conflict issues. For example, while a proposed transaction between a foundation and a board member's child would constitute a conflict of interest, a transaction involving a distant cousin might not. This is a matter of individual foundation judgment.

- a requirement that parties covered by the policy disclose any conflict to the board (or a designated board committee) in advance and leave the room during the board's discussion and decision
 - a prohibition against any attempt by a board member or foundation manager with a conflict to influence the decision (e.g., a board member with a conflict may not lobby other board members)
 - a requirement that the existence and resolution of the conflict be documented in the foundation's records (typically the minutes of the meeting when the transaction was considered)
 - a requirement that the foundation consult with its tax advisor as appropriate to ensure that the proposed transaction does not constitute an act of self-dealing
2. Require board members and foundation managers to fill out annual disclosure forms that list their affiliations and the names of businesses in which they have a significant ownership interest and, to the extent known, those of family members that are covered by the conflict-of-interest policy.
 3. Before approving a proposed conflict-of-interest transaction, make sure that all the requirements of the conflict policy have been followed, including the requirement to obtain market data showing that the proposed transaction is reasonable, and then document the basis for the board's action (including reliance on market data) in the minutes.

Even the most comprehensive conflict-of-interest policy cannot cover every conceivable situation where there might be the appearance of a conflict. Accordingly, conflict-of-interest policies should encourage board members and foundation managers to follow the process outlined above any time there might be the appearance or perception of conflict, even if it is not directly covered by the policy.

CONCLUSION

Conflicts of interest must be handled carefully to ensure good, objective decisions, to preserve the reputation of the foundation, its board, and its managers, and to protect against liability. To do this, 1) answer the questions posed at the start of this paper, 2) enact and follow a conflict-of-interest policy, and 3) make sure the foundation's board and managers understand how to recognize and handle a conflict when one occurs.

There are a number of resources available on this issue. BoardSource, the premier resource for nonprofit governance programs and services, provides information, publications, training, and consulting on nonprofit governance. Additional expertise and resources can be found at the local regional associations of grantmakers, the Forum of Regional Associations of Grantmakers, and the Council on Foundations.

TEST YOUR UNDERSTANDING OF CONFLICTS OF INTEREST

Now it is time to put the principles into practice. The following are several situations that foundations commonly encounter. Read each situation and think about whether the situation a) involves an act of self-dealing; b) is a breach of fiduciary duty; c) results in an actual or appearance of conflict that, unless handled properly, could damage a foundation's reputation; d) is all of the above; or e) is none of the above.

Situation 1: Foundation A owns its office building. It has extra space that it leases to a public charity grantee for a below-market rent. One of A's board members is on the board of the charity.

Answer: c) Because the grantee is a charitable organization, the transaction would not be an act of self-dealing or a breach of fiduciary duty. It would be treated like an in-kind grant from the foundation to the charity. However, because one of A's board members is on the charity's board, there is a conflict of interest and the transaction should be approved by board members who do not have a conflict.

Situation 2: Foundation B hires a board member's law firm to provide legal services at the firm's normal hourly rates, which are consistent with the rates charged by other law firms in town.

Answer: c) Because the transaction involves the provision of personal services at reasonable rates, it would not be an act of self-dealing or a breach of fiduciary duty. However, there is a conflict of interest and the transaction should be approved by board members who do not have a conflict.

Situation 3: Foundation C compensates its board members. One of the board members works for C's law firm, and he bills C at his normal hourly rates for attending board meetings.

Answer: d) Board compensation must be reasonable; the rate of pay should be comparable to what foundations pay board members for board service, not legal service.

Situation 4: Foundation D plans to lease office space from the father of a board member at a below-market rent.

Answer: a) The parents of board members are disqualified persons, and the lease is an act of self-dealing even though the terms are favorable to D.

Situation 5: Foundation E is a family foundation. It makes grants only to public charities that provide social services to low-income persons in the community. Some of E's board members and staff choose to provide volunteer services to its grantees.

Answer: e) The provision of volunteer services does not constitute the type of "financial or personal" interest that raises conflict-of-interest concerns.

Situation 6: Foundation F wants to sell an extra parcel of land. It obtains an appraisal of the value of the land and lists it with a broker. The sibling of a board member is the high bidder.

Answer: c) There is no act of self-dealing because siblings of board members are not disqualified persons, and no breach of fiduciary duty because the process ensures a fair purchase price. However, there is a conflict of interest and the decision to sell should be made by board members who do not have a conflict.

SAMPLE CONFLICT-OF-INTEREST POLICY AND QUESTIONNAIRE

Below is a sample conflict-of-interest policy that may be used by foundations to develop their own policy or to update an existing policy. The key elements include: 1) a definition of who is subject to the policy (in this case, board members and foundation managers, defined as “Covered Persons”); 2) a list of the transactions subject to the policy (“Covered Transactions”); and 3) the requirements applicable to Covered Persons in the case of proposed Covered Transactions. The latter include disclosing the conflict to the board, refraining from any effort to influence the decision about the Covered Transaction, and leaving the room during the board’s discussion and decision.

Note that the scope of the sample policy is fairly broad. The definition of “family member” includes, for example, stepchildren and in-laws. The definition of entities in which a Covered Person has a “material financial interest” is also quite broad, and includes entities in which a board member, foundation manager, and/or family member has a 10 percent interest. Foundations may choose to vary these definitions to reflect their particular circumstances.

Also attached is a sample disclosure questionnaire to be used in connection with this conflict-of-interest policy.

SAMPLE CONFLICT-OF-INTEREST POLICY FOR BOARD MEMBERS AND FOUNDATION MANAGERS

The ABC Foundation is a charitable organization whose board members and foundation managers are chosen to serve the public purposes to which it is dedicated. These persons have a duty to conduct the affairs of the Foundation in a manner consistent with such purposes and not to advance their personal interests. This conflict-of-interest policy is intended to permit the Foundation and its board members and foundation managers to identify, evaluate, and address any real, potential, or apparent conflicts of interest that might, in fact or in appearance, call into question their duty of undivided loyalty to the Foundation.

1. Covered Persons

This policy applies to the Foundation’s board members and foundation managers. Each Covered Person shall be required to acknowledge, not less than annually, that he or she has read and is in compliance with this policy.

2. Covered Transactions

This policy applies to transactions between the Foundation and a Covered Person, or between the Foundation and another party with which a Covered Person has a significant relationship. A Covered Person is considered to have a significant relationship with another party if:

- a) The other party is a family member, including a spouse, parent, sibling, child, stepchild, grandparent, grandchild, great-grandchild, in-law, or domestic partner.
- b) The other party is an entity in which the Covered Person has a material financial interest. This includes entities of which the Covered Person and all individuals or entities having significant relationships with the Covered Person own, in the aggregate, more than 10 percent.
- c) The Covered Person is an officer, director, trustee, partner, or employee of the other party.

A Covered Transaction also includes any other transaction in which there may be an actual or perceived conflict of interest, including any transaction in which the interests of a Covered Person may be seen as competing or at odds with the interests of the Foundation.

3. Disclosure, Refrain from Influence, and Recusal

When a Covered Person becomes aware of a proposed Covered Transaction, he or she has a duty to take the following actions:

- a) immediately disclose the existence and circumstances of such Covered Transaction to the Foundation's board in writing
- b) refrain from using his or her personal influence to encourage the Foundation to enter into the Covered Transaction
- c) physically excuse himself or herself from any discussions regarding the Covered Transaction except to answer questions, including board discussions and decisions on the subject

In order to assist the Foundation in identifying potential Covered Transactions, each Covered Person annually shall complete a Conflict-of-Interest Questionnaire provided by the Foundation, and shall update such Questionnaire as necessary to reflect changes during the course of the year. Completed Questionnaires shall be available for inspection by any board member, and may be reviewed by the Foundation's legal counsel.

4. Standard for Approval of Covered Transactions

The Foundation may enter into a Covered Transaction where a) such Transaction does not constitute an act of self-dealing, and b) the board determines, acting without the participation or influence of the Covered Person and based on comparable market data, that such transaction is fair and reasonable to the Foundation. The board shall document the basis for this determination in the minutes of the meeting at which the Covered Transaction is considered, and shall consult with the Foundation's legal advisor as necessary to ensure that the Transaction does not constitute an act of self-dealing.

5. Administration of Policy

This policy shall be administered by the board, which shall be responsible for the following:

- a) reviewing reports regarding the Conflict-of-Interest Questionnaires
- b) receiving disclosures of proposed Covered Transactions
- c) reviewing proposed Covered Transactions to determine whether they meet the above-described standard
- d) maintaining minutes and such other documentation as may be necessary and appropriate to document its review of Covered Transactions
- e) reviewing the operation of this policy and making changes from time to time as it may deem appropriate

Name: _____

Date: _____

RESOURCES

BoardSource

1828 L Street NW, Suite 900
Washington, DC 20016
202/452-6262
www.boardsource.org

Council of Michigan Foundations

P.O. Box 599, One South Harbor Avenue, Suite 3
Grand Haven, MI 49417
616/842-7080
www.cmif.org

Forum of Regional Associations of Grantmakers

1111 19th Street NW, Suite 650
Washington, DC 20036
202/467-1120
www.GivingForum.org

Council on Foundations

1828 L Street, NW, Suite 300
Washington, DC 20036
202/466-6512

Appendix 3

The Sarbanes-Oxley Act and Implications for Nonprofit Organizations

The Sarbanes-Oxley Act was signed into law on July 30, 2002. Passed in response to the corporate and accounting scandals of Enron, Tyco, and others in 2001 and 2002, the law's purpose is to rebuild public trust in America's corporate sector. The law requires that publicly traded companies adhere to significant new governance standards that broaden board members' roles in overseeing financial transactions and auditing procedures.

While nearly all of the provisions of the act apply only to publicly traded corporations, the passage of the bill served as a wake-up call to the entire nonprofit community. Indeed, several state legislatures have already passed or are considering legislation containing elements of the Sarbanes-Oxley Act to be applied to nonprofit organizations. In many instances, nonprofit organizations have adopted policies and altered governance practices in response to the act.

Nonprofit leaders should look carefully at the provisions of Sarbanes-Oxley, as well as their state laws, and determine whether their organizations ought to voluntarily adopt governance best practices, even if not mandated by law. This report will review those provisions and assess their relevance to nonprofit organizations.

Finally, it is important to note that two provisions of Sarbanes-Oxley apply to all entities, including nonprofit organizations. This report will review those features of the act that require immediate nonprofit compliance.

MAIN PROVISIONS OF THE SARBANES-OXLEY ACT

With two notable exceptions, the Sarbanes-Oxley Act affects only American publicly traded companies and regulates what boards must do to ensure auditors' independence from their clients. The act also creates and defines the role of the Public Company Accounting Oversight Board, an entity empowered to enforce standards for audits of public companies. The act explains processes for electing competent audit committee members and for ensuring that adequate reporting procedures are in place. In addition, it calls for regulations, and closes most of the loopholes, for all enterprises—for-profit and nonprofit—relating to document destruction and whistle-blower protection.

The following sections cover each of the major provisions of the law and discuss their relevance to nonprofit organizations. In addition, BoardSource and Independent Sector offer recommendations for how nonprofit leaders should implement various provisions of the law.

INDEPENDENT AND COMPETENT AUDIT COMMITTEE

Summary of Sarbanes-Oxley Provision

The Sarbanes-Oxley Act requires that each member of a company's audit committee be a member of the board of directors and be independent. "Independence" in the act is defined as not being part of the management team and not receiving any compensation (either directly or indirectly) from the company as a consultant for other professional services, though board service may be compensated.

In addition, a company must disclose whether it has at least one "financial expert" serving on its audit committee. If it does not have such an expert, it must disclose the rationale behind that decision. Who qualifies as a "financial expert" is still being debated. The Securities and Exchange Commission proposes a definition that relies on an individual's education and experience as a public accountant, auditor, or principal accounting officer. At present, however, the company's board seems to retain the final right to establish specific qualifications for a financial expert.

The audit committee is directly responsible for hiring the auditor, setting compensation, and overseeing the auditor's activities. It sets rules and processes for complaints concerning accounting and internal control practices.

Relevance to Nonprofit Boards

While not all nonprofits conduct outside audits, most nonprofit boards have established one or more financial committees (e.g., finance, audit, or investment). In those organizations that undertake annual audits, particularly medium to large nonprofit organizations, the board is likely to have a separate audit committee or subcommittee. In California, the Nonprofit Integrity Act of 2004 requires that any charity registered with the attorney general and receiving annual gross revenues of \$2 million or more must form an audit committee. Several other states have adopted similar rules, albeit at varying gross revenue thresholds.

It is good practice for nonprofit organizations to take steps to ensure the independence of the audit committee. While most nonprofit board members, serve as volunteers without any compensation and staff members do not participate as voting members, all nonprofit organizations should review their practices to ensure the independence of the audit committee. Also, many states provide additional liability protection for volunteer directors that may be lost if the directors are compensated for their service.

Because of recruitment priorities to create a well-balanced and diverse board, finding people with financial savvy may be challenging for boards. Nonprofit organizations need to ensure that board members of the audit committee have the financial competence to understand financial statements, to evaluate accounting firm bids to undertake auditing, and to make sound financial decisions as part of their fiduciary responsibilities. A nonprofit that has a limited number of financial experts on its board may struggle to fill the treasurer's position and to create a finance committee and an audit committee.

Recommendations

While it is too onerous to demand that all nonprofit organizations undertake a full audit, the board is responsible for assessing the potential benefits and costs of an independent audit. Nonprofits that expend more than \$500,000 of federal funds are required to conduct an annual audit. In addition, participating in the Combined Federal Campaign requires an audit at \$100,000. Any other charitable organization with \$1 million or more in total annual revenues (excluding houses of worship or other organizations that are exempt from filing Form 990) should have an audit conducted of its financial statements and consider attaching a copy to its Form 990 or 990-PF. Smaller charities with revenues of at least \$250,000 should have an audit or at least have their financial statements compiled by a professional accountant. The boards of nonprofit organizations that forego an audit should evaluate that decision periodically.

All nonprofit organizations that conduct outside audits, particularly medium to large organizations, should consider forming an audit committee and should separate the audit committee from the finance committee.

The audit committee should be composed of individuals who are not compensated for their service on this committee and do not have a financial interest in or any other conflict of interest with any entity doing business with the organization. Most nonprofit organizations have volunteer board members. Nonprofit organizations that do compensate board members should not compensate audit committee members for their additional service. In addition, all non-

profits should ensure that no members of staff, including the chief executive, serve on the audit committee, although it is reasonable to have the chief financial officer provide staff support to the audit committee. The chair of the audit committee should be a board member and it is reasonable to expect that the majority of the committee members are board members.

The audit committee should ensure that the auditing firm has the requisite skills and experience to carry out the auditing function for the organization and that its performance is carefully reviewed.

The audit committee should meet with the auditor, review the annual audit, and recommend its approval or modification to the full board. The full board should review the annual audit and the audit committee's report and recommendations. Ideally the full board would also meet with the auditor before formally accepting or rejecting the audit.

At least one member of the audit committee should meet the criteria of financial expert and have adequate financial savvy to understand, analyze, and reasonably assess the financial statements of the organization and the competence of the auditing firm. This may be a non-director advisory member where permitted by state law.

Orientation of board members should include financial literacy training.

To support the accounting field and help ensure that nonprofit boards have available financial expertise, professional accreditation and membership organizations of accountants should require CPAs to participate in a pro bono nonprofit board service program.

RESPONSIBILITIES OF AUDITORS

Summary of Sarbanes-Oxley Provision

The Sarbanes-Oxley Act requires that the lead and reviewing partner of the auditing firm rotate off of the audit every five years. This does not necessarily mean that the auditing firm must be changed, although that may be the most direct way to comply with this requirement.

In addition, the act prohibits the auditing firm from providing most non-audit services to the company concurrent with auditing services. This prohibition applies to bookkeeping, financial information systems, appraisal services, actuarial services, management or human resource services, investment advice, legal services, and other expert services unrelated to the audit. The board's audit committee may, however, pre-approve certain services (not included in the above categories), such as tax preparation, which can then be carried out by the auditing firm. In addition, the pre-approval requirement is waived for non-auditing services if the value of the non-auditing services is less than five percent of the total amount paid by the organization to the auditing firm for auditing services.

The act also requires that the auditing firm report to the audit committee all "critical accounting policies and practices" that are used by the organization, discussed with management, and represent the way management wants these policies and practices treated. These critical accounting practices include methods, assumptions, and judgments underlying the preparation of financial statements according to generally accepted accounting principles and assurance that any results would be disclosed in case of changed assumptions.

Relevance to Nonprofit Boards

Changing auditors (partner or firm) every five years is recommended. The rationale: Auditing firms may grow accustomed to the financial procedures within an organization after a certain number of years, and bringing in a new firm helps ensure that all practices are closely examined.

Nonprofit organizations would be well served to adopt the Sarbanes-Oxley rule of preventing auditing firms from providing non-auditing services, as this provision precludes a conflict of interest between the auditing firm and the client.

At a minimum, application of the rule should be considered in each case. At the same time, certain services can be pre-approved by the audit committee, and there is no reason why tax services and preparation of the Form 990 or 990-PF (for private foundations), for example, could not and should not be undertaken by a nonprofit's auditing firm. This can also save money for the client.

Finally, the provisions about disclosure to the audit committee of critical accounting policies and discussions with management also seem to follow good practice. Greater disclosure of these internal control practices and of management's views on them will foster more informed judgments by the audit committee, enhanced oversight by the board, and greater transparency. The critical accounting practices would include processes for segregation of duties, policies to use restricted funds for intended purposes, processes to review off-balance sheet transactions, and procedures for monitoring inventory fluctuations. In addition, the audit committee may be an effective committee for overseeing implementation and enforcement of the governing body's conflict-of-interest policy.

Recommendations

Large nonprofits should consider rotating at least the lead and reviewing partners of the audit firm every five years.

Nonprofit organizations should be cautious when using their auditing firms to provide non-auditing services (except for tax preparation, which should be approved in advance) while the firm is contracted to provide auditing services.

The audit committee should require each auditing firm to disclose to the committee all critical accounting policies and practices used within the organization, and to share with the committee any discussions with management about such policies and practices.

CERTIFIED FINANCIAL STATEMENTS

Summary of Sarbanes-Oxley Provision

The chief executive and the chief financial officers must certify that financial statements are appropriate and that they fairly present the financial condition and operations of the company. There are criminal sanctions for false certification, but violations of this statute must be knowing and intentional to indicate liability.

In addition, to avoid conflicts of interest, the CEO, CFO, controller, and chief accounting officer cannot have worked for the auditing firm for one year preceding the audit.

Relevance to Nonprofit Organizations

Any CFO who is responsible for generating timely and accurate financial statements for the company or organization should feel comfortable about certifying document integrity.

In a for-profit company, a positive bottom line is the CEO's responsibility. Business acumen, capacity to interpret financial statements in detail, and skillfulness in convincing the board and shareholders that the corporation is meeting all expectations are obvious characteristics in a manager. Likewise, a nonprofit chief executive may be handicapped without adequate financial skills. He or she may be hired, however, for other qualities. Nonprofit CEOs may excel in fundraising, knowledge of the organization's field of interest, or a variety of other skills. Lack of superior financial prowess must be compensated for by a skillful financial officer; without that person, the organization cannot convince donors and funders that their money is properly managed. Nevertheless, it is still the responsibility of the CEO to ensure good stewardship of the organization's resources.

Under Sarbanes-Oxley, CEO and CFO certification carries with it the weight of the law, in part to ensure that both the CEO and CFO know and understand the financial statements. For a nonprofit organization, CEO and CFO sign-

off on financial statements would not carry the weight of law (although some states are now considering adopting a similar requirement), but it would signal the importance that the CEO, in particular, attaches to understanding the nonprofit's financial condition.

For nonprofit organizations, a key financial document is the Form 990 or 990-PF. The form requires a signature from an officer of the organization. Research from a number of studies reveals that the accuracy of reporting leaves much to be desired. Many of the errors in the Form 990 and 990-PF relate to failures to complete all forms, including Schedule A. Other problems include presenting an inaccurate report on fundraising costs, thereby distorting the required financial picture of the organization's operations. Thus, it is critical that nonprofit organizations examine their financial systems, policies, and reporting to help improve the accuracy and completeness of these forms.

There is, in all likelihood, considerably less staff movement in the nonprofit world between accounting firms and client organizations than there is in the for-profit world. Furthermore, because nonprofit executives do not receive lucrative stock options, the likelihood of possible conflicts of interest from an auditor joining the executive staff of a nonprofit client is relatively small.

Recommendations

CEOs or CFOs, while they need not certify the financial statements of the organization, do need to fully understand such reports and make sure they are accurate and complete. Signing off provides formal assurance that both the CEO and the CFO have reviewed them carefully and stand by them.

The CEO and CFO should review the Form 990 or 990-PF before it is submitted to ensure that it is accurate, complete, and filed on time.

Regardless of whether the CEO and CFO certify the financial report, the board has the ultimate fiduciary responsibility for approving financial reports. Just as the financial and audit reports are reviewed and approved by the audit committee and the board, the Form 990 or 990-PF should also be reviewed and approved. At a time when Forms 990 and 990-PF are published on the Internet by third parties, it is more important than ever that directors be familiar with the contents of the organization's 990 each year.

INSIDER TRANSACTIONS AND CONFLICTS OF INTEREST

Summary of Sarbanes-Oxley Provision

The act generally prohibits loans to any directors or executives of the company.

Relevance to Nonprofit Organizations

Nonprofits are currently highly regulated with respect to financial transactions that take place within the organization. Private inurement, excessive personal benefit, and self-dealing all cause serious penalties for any nonprofit that steps out of line. "Intermediate sanctions" laws specifically address compensation and excess benefit transactions with "disqualified" individuals (generally board members and executive staff).

Providing private loans to insiders—the specific item included in the Sarbanes-Oxley Act—is not a common practice in the nonprofit sector. However, when it has occurred, it has caused problems either because of the perception of a conflict of interest or because it has not been appropriately documented as part of executive compensation. In some states, nonprofit law expressly prohibits loans to directors and officers.

Recommendations

Because the practice of providing loans to nonprofit executives has been a source of trouble in the past and because the practice of providing loans to executives is specifically prohibited under Sarbanes-Oxley and in some states, it is strongly recommended that nonprofit organizations not provide personal loans to directors or executives.

If such loans are provided, they should be formally approved by the board, the process for providing the loan should be documented, and the value and terms of the loan should be disclosed.

To guide the board and staff in independent decision making, the organization must have a conflict-of-interest policy requiring board members to disclose annually their potential conflicts of interest, and this policy must be enforced without fail.

DISCLOSURE

Summary of Sarbanes-Oxley Provision

The Sarbanes-Oxley Act requires a number of disclosures, including information on internal control mechanisms, corrections to past financial statements, and material off-balance sheet transactions (adjustments). The act also requires companies to disclose information on material changes in the operations or financial situation of the company on a regular basis.

Relevance to Nonprofit Organizations

While nonprofit organizations do not file most of the reports that publicly traded companies are required to file, they should nevertheless provide their donors, clients, public officials, the media, and others with an accurate picture of their financial condition. Current law already requires tax-exempt organizations to make their Forms 990 or 990-PF freely available to anyone who requests them in writing or in person. These information returns, as mentioned before, need improvements both in accuracy and in timeliness of disclosure. One way to achieve that objective is through electronic filing, something the IRS is currently pursuing and that the nonprofit community generally endorses.

Recommendations

Nonprofit organizations should improve the timeliness, accuracy, and completeness of their Forms 990 or 990-PF by filing electronically when that option is available to them. Nonprofits should strive for greater disclosure and transparency.

Nonprofits should not rely on automatic extensions for filing Forms 990 and 990-PF without cause.

Audited financial statements should be easily accessible for review.

All nonprofit organizations should comply with the two provisions of the Sarbanes-Oxley Act that apply to all entities because they are amendments to the federal criminal code.

WHISTLE-BLOWER PROTECTION

Summary of Sarbanes-Oxley Provision

The Sarbanes-Oxley Act provides protections for whistle-blowers and imposes criminal penalties for actions taken in retaliation against those who risk their careers by reporting suspected illegal activities in an organization. It is illegal for any entity—for-profit or nonprofit—to punish a whistle-blower in any manner.

Relevance to Nonprofit Organizations

Nonprofits must start by protecting themselves. They must eliminate careless and irresponsible accounting practices and obtain an internal audit that brings to light weak spots and installs processes that are not vulnerable to fraud and abuse. Written policies that are vigorously enforced by executive staff and the board send a message that misconduct is not tolerated. These policies should cover any unethical behavior within the organization—including sexual harassment.

Each organization must develop procedures for handling employee and volunteer complaints, including the establishment of a confidential and anonymous mechanism to encourage employees and volunteers to report any inappropriateness within the entity's financial management. No punishment for reporting problems—including firing, demotion, suspension, harassment, failure to consider the employee for promotion, or any other kind of discrimination—is allowed. Even if the claims are unfounded, the organization may not reprimand the employee. The law does not force the employee to demonstrate misconduct; a reasonable belief or suspicion that a fraud exists is enough to create a protected status for the employee.

Recommendations

Nonprofits must develop, adopt, and disclose a formal process to deal with complaints and prevent retaliation.

Nonprofit leaders must take any employee and volunteer complaints seriously, investigate the situation, and fix any problems or justify why corrections are not necessary.

DOCUMENT DESTRUCTION

Summary of Sarbanes-Oxley Provision

The Sarbanes-Oxley Act addresses destruction of litigation-related documents. The law makes it a crime to alter, cover up, falsify, or destroy any document (or persuade someone else to do so) to prevent its use in an official proceeding (e.g., federal investigation or bankruptcy proceedings). The act turns intentional document destruction into a process that must be monitored, justified, and carefully administered.

Relevance to Nonprofit Organizations

Individuals, nonprofit organizations, and companies regularly need to shred or otherwise dispose of unnecessary and outdated documents and files. Like their for-profit counterparts, nonprofit organizations need to maintain appropriate records about their operations. For example, financial records, significant contracts, documentation of real estate and other major transactions, employment files, and documentation of fundraising obligations should be archived according to guidelines established by the organization.

Recommendations

A nonprofit organization should have a written document retention and periodic destruction policy. Such a policy also helps limit accidental or innocent destruction.

The document retention policy should include guidelines for handling electronic files and voicemail. Electronic documents and voicemail messages have the same status as paper files in litigation-related cases. The policy should also cover back-up procedures, archiving of documents, and regular assessments of the reliability of the system.

If an official investigation is underway or even suspected, nonprofit management must stop any document purging in order to avoid criminal obstruction charges.

CONCLUSION

The Sarbanes-Oxley Act has now been in force for several years. The legal climate has intensified in the nonprofit sector as congressional committees and state legislatures are actively proposing new legislation to regulate organizations. Individual nonprofits have begun to identify loopholes—and figure out how to eliminate them. Watchdog agencies and other nonprofit field-building organizations are reconsidering assumptions and standard operating procedures in an effort to identify guidelines, standards, and best practices in the sector.

Regardless of the present scope of existing and potential legislation at the state and federal level, nonprofit organizations have heard the wake-up call. For all of us in the sector, the Sarbanes-Oxley Act spearheaded a renewed realization that nonprofit organizations rely on—and must protect—the indispensable and unequivocal confidence and trust of our constituents. Self-regulation will always prove more powerful than compulsory adherence to laws.

ADDITIONAL RESOURCES

Press Release from the Office of the New York State Attorney General www.oag.state.ny.us/press/2003/mar/mar12a_03.html

“Strengthening Transparency, Governance, Accountability of Charitable Organizations: a Final Report to Congress and the Nonprofit Sector, June 2005.” Panel on the Nonprofit Sector, www.nonprofitpanel.org/final.

Summary of the Sarbanes-Oxley Act www.aicpa.org/sarbanes/index.asp.

Recommendations from the National Association of Corporate Directors Concerning Reforms in the Aftermath of the Enron Bankruptcy www.nacdonline.org/nacd/enron_recommendations.asp

“Corporate Governance. The Wall Street Journal Reports.” *Wall Street Journal*, February 24, 2003.

“Raising the Bar on Governance: Board Committee Performance in the New Era of Accountability.” American Governance & Leadership Group, 2002.

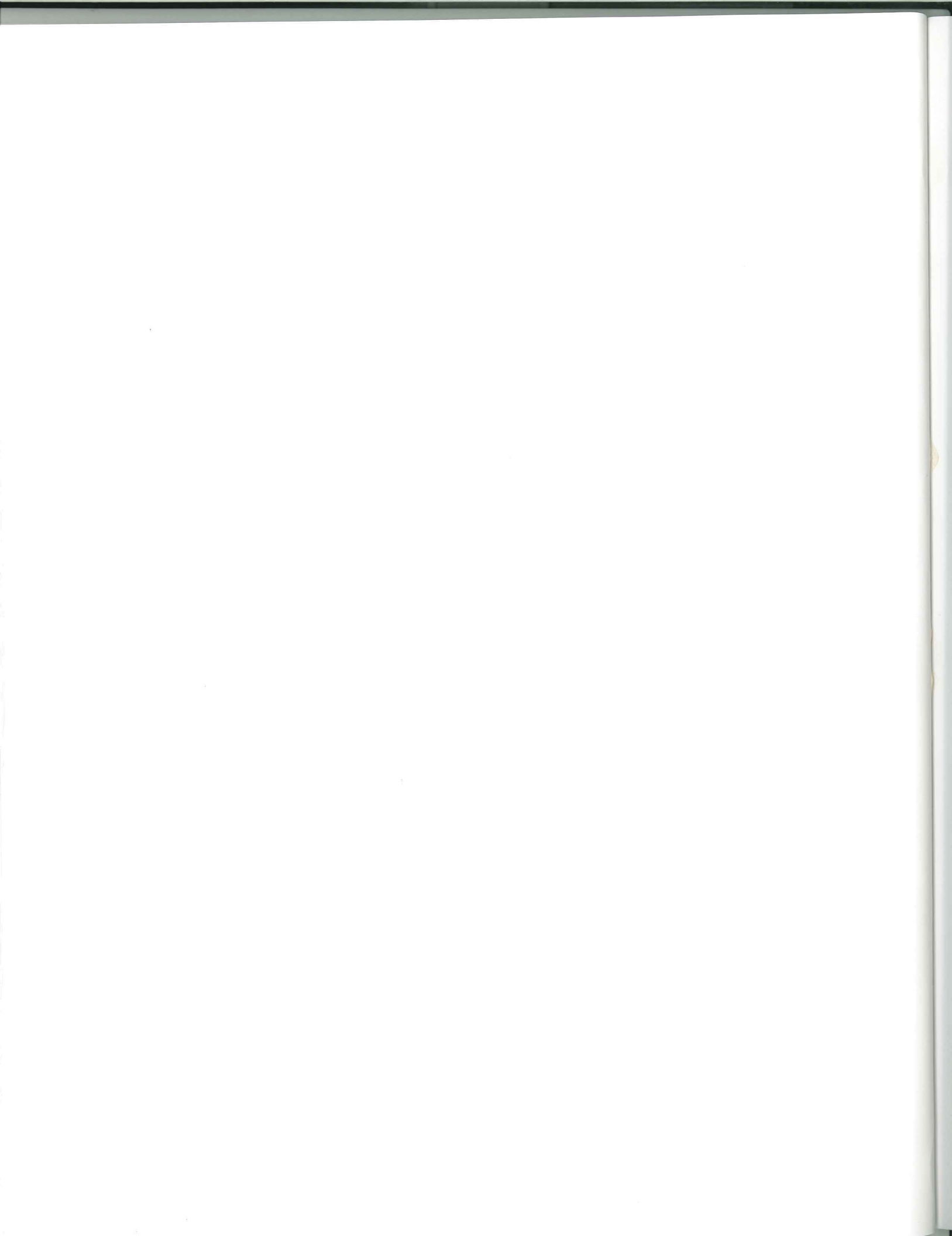
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Kokourek, Paul F, Christian Burger, and Bill Birchard. “Corporate Governance: Hard Facts about Soft Behaviors: Seven steps to fixing what Sarbanes-Oxley can't.” *strategy+ business*, Issue 30, Spring 2003.

McLaughlin, Thomas A. “For-Profit Spillover: New Regulation of Independence.” *NonProfit Times*, February, 1, 2003.

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Appendix 4

Glossary

The following terms are commonly used in the field of philanthropy.

501(c)(3):

A section of the Internal Revenue Code that designates an organization as charitable and tax-exempt. Organizations qualifying under this section include religious, educational, charitable, amateur athletic, and scientific or literary groups, organizations testing for public safety, and organizations involved in prevention of cruelty to children or animals. Most organizations seeking foundation or corporate contributions secure a Section 501(c)(3) classification from the IRS. Note: The Tax Code lists in section 501(c)(4)-(26) other nonprofit organizations whose function is not solely charitable (e.g., professional or veterans organizations, chambers of commerce, fraternal societies).

509(a):

A section of the Tax Code that defines public charities (as opposed to private foundations). A 501(c)(3) organization also must have a 509(a) designation to further define the agency as a public charity.

Affinity Group:

A separate and independent coalition of grantmaking institutions or individuals associated with such institutions, that shares information or provides professional development and networking opportunities to individual grantmakers with a shared interest in a particular subject or funding area.

Agency Endowments:

A fund or funds held for the benefit of a specific charity. Legally the assets are the property of the community foundation, but they are subject to a restriction that all distributions from the fund must benefit the named charity. The fund may be established by a transfer of assets directly from the beneficiary charity or through contributions made by donors for the benefit of the charity. Under Financial Accounting Standard Board Statement 136, assets transferred directly by the charity must be recorded as a liability on the community foundation's books. Assets contributed by individual donors to a fund for a designated charity are assets of the community foundation.

Annual Report:

A voluntary report published by a foundation or corporation describing its grant activities. It may be a simple, typed document listing the year's grants, or an elaborately detailed publication. A growing number of foundations and corporations use an annual report as an effective means of informing the community about their contributions activities, policies, and guidelines.

Articles of Incorporation:

A document filed with the secretary of state or other appropriate state office by persons establishing a corporation. This is the first legal step in forming a nonprofit corporation.

Assets:

Cash, stocks, bonds, real estate, or other holdings of a foundation. Generally, assets are invested and the income is used to make grants.

Bequest:

A sum of money made available upon the donor's death.

Bricks and Mortar:

An informal term indicating grants for buildings or construction projects.

Bylaws:

Rules governing the operation of a nonprofit corporation. Bylaws often provide the methods for the selection of directors, the creation of committees, and the conduct of meetings.

Capital Campaign:

Also referred to as a Capital Development Campaign, a capital campaign is an organized drive to collect and accumulate substantial funds to finance major needs of an organization, such as a building or major repair project.

Challenge Grant:

A grant that is made on the condition that other monies must be secured, either on a matching basis or via some other formula, usually within a specified period of time, with the objective of stimulating giving from additional sources.

Charity:

In its traditional legal meaning, the word "charity" encompasses education, promotion of health, relief of poverty or distress, and other purposes that benefit the community. Nonprofit organizations that are organized and operated to further one of these purposes generally will be recognized as exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (see 501(c)(3)) and will be eligible to receive tax-deductible charitable gifts.

Community Foundation:

A tax-exempt, nonprofit, autonomous, publicly supported, philanthropic institution composed primarily of permanent funds established by many separate donors for the long-term, charitable benefit of the residents of a defined geographic area. Typically, a community foundation serves an area no larger than a state. Community foundations provide an array of services to donors who wish to establish endowed funds without incurring the administrative and legal costs of starting independent foundations.

Corporate Foundation:

A private foundation that derives its grantmaking funds primarily from the contributions of a profit-making business. This company-sponsored foundation often maintains close ties with the donor company, but it is a separate, legal organization, sometimes with its own endowment, and is subject to the same rules and regulations as other private foundations (See Corporate Giving Program).

Corporate Giving Program:

A grantmaking program established and administered within a profit-making company. Gifts or grants go directly to charitable organizations from the corporation. Also called direct giving programs, corporate giving programs do not have a separate endowment; their expense is planned as part of the company's annual budgeting process and usually is funded with pretax income.

Custodian:

A bank or other financial institution that has custody of stock certificates and other assets of a mutual fund, individual, corporation, or institution. All custodians can hold assets in safekeeping, collect income on securities in custody, settle transactions, invest cash overnight, handle corporate accounting, and provide accounting reports.

Decline:

The refusal or rejection of a grant request. Also referred to as a denial. Some declination letters explain why the grant was not made, but many do not.

Discretionary Funds:

Grant funds distributed at the discretion of one or more trustees, which usually do not require prior approval by the full board of directors. The governing board can delegate discretionary authority to staff.

Donee:

See Grantee.

Donor-advised Fund (community foundation):

A fund held by a community foundation where the donor, or a committee appointed by the donor, may recommend eligible charitable recipients for grants from the fund. The community foundation's governing body must be free to accept or reject the recommendations. Donor-advised funds are now also statutorily defined by the Pension Protection Act of 2006. For more information, see www.cof.org/ppa.

Due Diligence:

The degree of prudence that might be properly expected from a reasonable person in the circumstances; applicable to foundation personnel who act in a fiduciary capacity (See Fiduciary Duty).

Endowment:

The principal amount of gifts and bequests that are accepted, subject to a requirement that the principal be maintained intact and invested to create a source of income for a foundation. Donors may require that the principal remain intact in perpetuity, for a defined period of time, or until sufficient assets have been accumulated to achieve a designated purpose.

Excise Tax on Net Investment Income (private foundations):

A tax on the net investment income of private foundations. Normally set at 2 percent per year, the rate may be reduced to 1 percent if the foundation meets certain expenditure requirements.

Expenditure Responsibility:

The process that must be followed when a grant is made from a private foundation or donor-advised fund to any non-charity or a narrow class of charities. This process is required by law to ensure that the funds are spent for charitable purposes and not for private gain or partisan political activities. In part, such grants require a pre-grant inquiry and a detailed, written agreement. Special reports on the status of the grant must be filed with the IRS, and the grantees must be listed on the foundation's IRS Form 990-PF or Form 990.

Family Foundation:

“Family foundation” is not a legal term, and therefore, it has no precise definition. Yet, approximately two-fifths of the estimated 46,832 private foundations in this country are believed to be family managed. The Council on Foundations defines a family foundation as one whose funds are derived from members of a single family. At least one family member must continue to serve as an officer or board member of the foundation, and as the donor(s), the family member(s) or their relatives play a significant role in governing and/or managing the foundation throughout its life. Most family foundations are run by family members, who serve as trustees or directors on a voluntary basis and who receive no compensation. In many cases, second- and third-generation descendants of the original donors manage the foundation. Most family foundations concentrate their giving locally, in their communities.

Fiduciary Duty:

The legal responsibility for investing money or acting wisely on behalf of another. Managers of charitable entities have fiduciary obligations to the charity (See Due Diligence).

Financial Report:

An accounting statement detailing financial data, including income from all sources, expenses, assets, and liabilities. A financial report may also be an itemized accounting that shows how grant funds were used by a donee organization. Most foundations require a financial report from grantees.

Form 990/Form 990-PF:

The IRS forms filed annually by public charities and private foundations respectively. The letters PF stand for private foundation. The IRS uses this form to assess compliance with the Internal Revenue Code. Both forms list organization assets, receipts, expenditures, and compensation of officers. Form 990-PF includes a list of grants made during the year by private foundations.

Funding Cycle:

A chronological pattern of proposal review, decision making, and applicant notification. Donor organizations generally make grants at set intervals (quarterly, semiannually, annually, etc.).

Grant:

An award of funds to an organization or individual to undertake charitable activities.

Grant Guidelines:

A statement of a foundation's goals, priorities, criteria, and procedures for applying for a grant.

Grant Monitoring:

The ongoing assessment of the progress of activities funded with the objective of determining if the terms and conditions of the grant are being met and if the goal of the grant is likely to be achieved.

Grantee:

The individual or organization that receives a grant.

Grantor:

The individual or organization that makes a grant. Also called a funder.

Hedging:

Hedging can include one or more strategies used to offset specific investment risk. A perfect hedge is one eliminating the possibility of future gain or loss. Examples include owning real estate to protect against inflation, owning high-quality, long-term bonds to protect against deflation, and selling stocks short in anticipation of a downturn in the stock market.

In-Kind Contribution:

A donation of goods or services rather than cash or appreciated property.

Independent Foundation:

Private foundations, often founded by one individual, often by bequest. Some were once governed by a family, but are no longer. They are run by boards made up of community, business, and academic leaders. Private foundations make grants to other tax-exempt organizations to carry out their charitable purposes. Private foundations must make charitable expenditures of approximately 5 percent of the market value of their assets each year. Although exempt from federal income tax, private foundations must pay a yearly excise tax of 1 or 2 percent of their net investment income. The Ford Foundation and the John D. and Catherine T. MacArthur Foundation are two examples of well-known independent private foundations.

Intermediate Sanctions:

Penalty taxes applied to disqualified persons of public charities (see Disqualified Person) that receive an excessive benefit from financial transactions with the charity. An excessive benefit may result from overcompensation for services or from other transactions such as charging excessive rent on property rented to the charity. Unlike private foundations, public charities are not barred from engaging in financial transactions with disqualified persons as long as the transaction is fair to the charity. Penalty taxes also may apply to organization managers, such as the charity's board, that knowingly approve an excess benefit transaction.

Internal Revenue Service (IRS):

The federal agency with responsibility for regulating foundations and their activities. Online at www.irs.gov.

Investment Consultants:

Advisors who aid in the investment decisions of individuals and financial committees and officers of institutions. Investment consultants provide information and make recommendations about asset allocation, manager structures, manager reviews, and portfolio performance.

Investment Manager:

An individual, firm, or committee responsible for making day-to-day decisions to buy, hold, or sell assets. Also known as a money manager or investment advisor.

Jeopardy Investment:

An investment that risks the foundation's ability to carry out its exempt purposes. Although certain types of investments are subject to careful examination, no single type is automatically a jeopardy investment. Generally, a jeopardy investment has been made when a foundation's managers have failed to exercise ordinary business care and prudence. The result of a jeopardy investment may be penalty taxes imposed upon a foundation and its managers (See Program-Related Investment).

Letter of Intent:

A grantor's letter or brief statement indicating intention to make a specific gift.

Letter of Inquiry:

Also referred to as a query letter. A brief letter outlining an organization's activities and a request for funding sent to a prospective donor to determine if there is sufficient interest to warrant submitting a full proposal. This saves the time of the prospective donor and the time and resources of the prospective applicant.

Leverage:

When a small amount of money is given with the express purpose of attracting funding from other sources or of providing the organization with the tools it needs to raise other kinds of funds. Sometimes known as the "multiplier effect."

Lobbying:

Efforts to affect legislation by influencing the opinion of legislators, legislative staff, and government administrators directly involved in drafting legislative proposals. The Internal Revenue Code sets limits on lobbying by organizations that are exempt from tax under Section 501(c)(3). Public charities (see Public Charity) may lobby as long as lobbying does not become a substantial part of their activities. Private foundations (see Private Foundations) generally may not lobby except in limited circumstances such as on issues affecting their tax-exempt status or the deductibility of gifts to them. Conducting nonpartisan analysis and research and disseminating the results to the public generally are not lobbying for purposes of these restrictions.

Matching Grant:

Grants given to match gifts made by others. The match amount (e.g., 1:1, 2:1) is specified by the funder.

Operating Foundation:

Also called private operating foundations, operating foundations are private foundations that use the bulk of their income to provide charitable services or to run charitable programs of their own. These make few, if any, grants to outside organizations. To qualify as an operating foundation, specific rules, in addition to the applicable rules for private foundations, must be followed. The Carnegie Endowment for International Peace and the Getty Trust are examples of operating foundations.

Operating Support:

A contribution given to cover an organization's day-to-day, ongoing expenses, such as salaries, utilities, office supplies, etc.

Pass-through Foundation:

Foundations that receive monies and make distributions to donees, with little or no principal remaining with the foundation.

Public Support Test:

A test used by the IRS to distinguish private foundations from public charities.

Philanthropy:

The origin of the word philanthropy is Greek and means "love for mankind." Today, philanthropy includes the concept of voluntary giving by an individual or group to promote the common good. Philanthropy also commonly refers to grants of money given by foundations to nonprofit organizations. Philanthropy addresses the contribution of

an individual or group to other organizations that in turn work for the cause of alleviating poverty or social problems, thereby improving the quality of life for all citizens. Philanthropic giving supports a variety of activities including research, health, education, arts, and culture, as well as alleviating poverty.

Portfolio:

The total investment pool held by an organization, normally divided into several segments such as equities, fixed income, and real estate. The asset allocation of a portfolio will reflect the risk level with which the sponsor is comfortable and will impact the portfolio's total return. Some foundations also speak of their grants portfolio, which is the mix of funding.

Post-grant Evaluation:

A review of the results of a grant, with the emphasis on whether or not the grant achieved its desired objective.

Private Foundation:

A nongovernmental, nonprofit organization with funds (usually from a single source, such as an individual, family or corporation) and programs that are managed by its own trustees or directors and established to maintain or aid, primarily through grantmaking, social, educational, religious or other charitable activities serving the common good. U.S. private foundations are tax exempt under Section 501(c)(3) of the Internal Revenue Code and are classified by the IRS as a private foundation as defined in the code.

Program-Related Investment:

A loan or other investment made by a private foundation to a profit-making or nonprofit organization for a project related to the foundation's stated purpose and interests. Program-related investments are an exception to the general rule barring jeopardy investments. Often, program-related investments are made from a revolving fund; the foundation generally expects to receive its money back with limited, or below-market, interest, which then will provide additional funds for loans to other organizations. A program-related investment may involve loan guarantees, purchases of stock, or other kinds of financial support.

Public Charity:

A nonprofit organization that is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and that receives its financial support from a broad segment of the general public. Religious, educational, and medical institutions are deemed to be public charities. Other organizations exempt under Section 501(c)(3) must pass a public support test (see Public Support Test) or must be formed to benefit an organization that is a public charity to be considered public charities (see Supporting Organizations). Charitable organizations that are not public charities are private foundations and are subject to more stringent regulatory and reporting requirements (see Private Foundations).

Rate of Return:

A measure of investment performance of an asset or pool of assets. It should always be determined on a total-return basis, i.e., including realized and unrealized changes in market value in addition to earned income (e.g., dividends and interest income). Managers may report returns before or after management advisory fees, but returns are always reported after brokerage and trading costs.

Restricted Funds:

Assets or income that are restricted in their use, in the types of organizations that may receive grants from them, or in the procedures used to make grants from such funds.

Seed Money:

A grant or contribution used to start a new project or organization.

Site Visit:

A visit to a donee organization at its office location or area of operation. May include a meeting with the organization's staff or directors or recipients of its services.

Socially Responsible Investing:

Also referred to as ethical investing and social investing, this is the practice of aligning a foundation's investment policies with its mission. This may include making program-related investments and refraining from investing in corporations with products or policies inconsistent with the foundation's values.

Spending Policy:

An agreed-upon policy that determines what percentage of a group of assets, such as an endowment, should be spent to cover both operating costs and grants of an institution. Typical spending rules combine calculations based on previous years' spending, the current year's income, investment return rates, and the policy of the foundation covering grant commitments.

Supporting Organization:

A supporting organization is a charity that is not required to meet the public support test because it supports a public charity. To be a supporting organization, a charity must meet one of three complex legal tests that assure, at a minimum, that the organization being supported has some influence over the actions of the supporting organization. Although a supporting organization may be formed to benefit any type of public charity, the use of this form is particularly common in connection with community foundations. Supporting organizations are distinguishable from donor-advised funds because they are distinct legal entities. With the passage of the Pension Protection Act of 2006, legal compliance for supporting organizations became more complex. See www.cof.org/ppa for details.

Tax-Exempt Organizations:

Organizations that do not have to pay state and/or federal income taxes. Organizations other than churches seeking recognition of their status as exempt under Section 501(c)(3) of the Internal Revenue Code must apply to the IRS. Charities may also be exempt from state income tax, sales tax, and local property tax.

Trust:

A legal device used to set aside money or property of one person for the benefit of one or more persons or organizations. A private foundation can be organized as a charitable trust and is governed by a trust instrument that appoints initial trustees, sets forth their powers, and provides for orderly selection of future trustees.

Trustee:

The person(s) or institutions responsible for the administration of a trust.

Unrestricted Funds:

Normally found at community foundations, an unrestricted fund is one that is not specifically designated to particular uses by the donor, or for which restrictions have expired or been removed.

Appendix 5

Other Resources

CONFERENCES AND MEETINGS

Each year, there are several national conferences of interest to foundation board members.

- **Council on Foundations Fall Conference for Community Foundations.** Held every year in September or October, this conference provides sessions specifically designed for board members and staff of community foundations.
- **Center for Community Foundation Excellence—Community Foundations Fundamentals.** This course helps community foundation staff board members, and volunteers master the unique aspects of the community foundation field. You'll learn about effective practices, get helpful tools and information, and have the opportunity to network with others in the field. Comprehensive and engaging, these courses are an efficient and affordable way to increase your knowledge of the field, to help you work more effectively. For more information or to register, email community@cof.org.
- **BoardSource Conference.** The BoardSource Leadership Forum, an annual conference addressing issues of governance in nonprofit organizations, offers the preeminent forum for nonprofit board members, chief executives, grantmakers, staff, volunteers, consultants, and opinion leaders to discuss the major forces shaping the nonprofit world today.
- **Trustee Leadership Seminar and Institute for New Grantmakers.** Held each year, these are collaborations among the Council on Foundations, the Association of Small Foundations, and regional associations of grantmakers. These programs enable new grantmakers and board members to strengthen their core competencies, meet colleagues, and receive valuable resources and training.
- **Council on Foundations Annual Conference.** Held each April/May, the Annual Conference is the world's largest gathering of grantmakers, featuring sessions for board members, corporate grantmakers, international grantmakers, and private, family and community foundations.
- **BoardSource Customized Consulting.** Contact BoardSource to customize a board development program that meets your needs. Whether you are new to serving on a board, experiencing growing pains, or rethinking your board's needs, BoardSource consultants can help.
- **Council on Foundations Family Foundation Conference.** Held in February, the Family Foundation Conference features sessions for family and staff at all experience levels, on management, governance, grantmaking, and family dynamics. The conference includes a Next Generation Retreat, a Family Foundation Institute for newcomers, and a Veterans Track. Especially suitable for donor advisors and successor advisors.

EMAIL LISTS

You can keep in close contact with colleagues right from your own desk. An e-list is an email grouping of people with common interests, providing a place for discussion and information sharing. The Council on Foundations sponsors a variety of email lists so you can stay up to date on news and ask or answer questions. Among those offered at the Council: CEONet, AdNet (development), ProNet (program), FAOG (finance and administration), and COMMA (communications).

- **BoardSource E-Updates.** Nonmembers can sign up to receive email newsletters and notices of new products, services, and workshops as well as learn about BoardSource newest e-book releases. E-updates will help you become better informed of nonprofit board trends. Visit www.boardsource.org.
- **Community Foundation Board Member E-List.** (for Council on Foundations members only) This email service provides community foundation board members with information about upcoming events of interest and an outlet to ask questions of their peers. For information, ask for the community foundation list administrator at 202/466-6512.

PERIODICALS

Consider subscribing to the following magazines and newsletters, many of which are also available online.

Board Member. Published by BoardSource, this newsletter features news and resources for nonprofit leaders. For more information, visit www.boardsource.org.

Chronicle of Philanthropy. The newspaper of the nonprofit world, the biweekly *Chronicle* features news and information for charity leaders, fundraisers, grantmakers, and other people involved in the philanthropic enterprise. A subscription includes full access to the website database and news updates by email. An online-only subscription is also available. For more information, visit www.philanthropy.com.

The Nonprofit Times. Published 24 times a year, this publication will provide you with useful information on the business of managing your nonprofit organization. Free subscriptions are offered to full-time U.S. nonprofit executives. For more information, visit www.nptimes.org.

Washington Quarterly. Published by the Council on Foundations, this newsletter informs Council members about legislative and regulatory developments affecting the foundation community. For more information, visit www.cof.org or contact the Council's Government Relations Department at 202/466-6512, or govt@cof.org.

ORGANIZATIONS THAT SUPPORT FOUNDATIONS

National Organizations

BoardSource

1828 L Street, NW, Suite 900

Washington, DC 20036

202/452-6262

www.boardsource.org

BoardSource is an international organization dedicated to increasing the effectiveness of nonprofit organizations through the strengthening of their boards of directors by providing information, resources and consulting services.

Council on Foundations

1828 L Street, NW, Suite 300

Washington, DC 20036

202/466-6512

www.cof.org

The national membership association for foundations and corporate giving programs serves the public good by promoting and enhancing responsible and effective philanthropy. The Council provides the field with national conferences, critical resources and individual assistance. The governing board programs provides services directly to board members.

Regional Associations of Grantmakers

Regional associations of grantmakers are nonprofit membership associations of foundations and related organizations that share a common goal: to strengthen philanthropy in a distinct geographic region city, state, or multi-state area. Regional grantmaking members include private and independent foundations, community foundations, and corporate foundations and giving programs. Some regional grantmakers include in their membership other related organizations, such as financial advisor firms or nonprofit grantseeking groups. To find the group nearest you, visit www.givingforum.org.

Forum of Regional Associations of Grantmakers

1111 19th Street, NW

Washington, DC 20036

202/467-1120

www.givingforum.org

A membership association of the nation's largest regional associations, the forum promotes expanded, effective philanthropy by enhancing the capacity of regional associations of grantmakers.

The Foundation Center

79 Fifth Avenue
New York, NY 10003-3076
212/620-4230
www.fdncenter.org

The Foundation Center is an essential resource for grantseekers looking for information on appropriate funding sources for their programs and organizations. It focuses on furthering the public understanding of foundations by conducting research in the field. Foundation Center has field offices in San Francisco, Washington, DC, Atlanta, and Cleveland.

Affinity Groups

Affinity groups and grantmaker associations represent a variety of different issues and population groups. They are a source for up-to-date grantmaking information in their areas of interest. Some groups emphasize networking and information exchange among members, while others advocate for an issue or cause. Generally, these groups serve the grantmaking community, although some include grantee organizations as members. The typical group is a network managed by volunteers, although a growing number are becoming nonprofit organizations in their own right. For more information on affinity groups, contact the Council on Foundations' Affinity Group Services department at 202/467-0398 or visit www.cof.org/publications.

Independent Sector

1200 18th Street, NW, Suite 200
Washington, DC 20036
202/467-6100
www.independentsector.org

Independent Sector is a nonprofit coalition of more than 850 corporations, foundations, and voluntary organizations. Its mission is to create a national forum to encourage giving and volunteering by individuals and organizations.

Indiana University Center on Philanthropy

550 West North Street, Suite 301
Indianapolis, IN 46202-3162
317/274-4200
www.philanthropy.iupui.edu

This academic center is dedicated to increasing the understanding of philanthropy and improving its practice through research, teaching, and public service.

Philanthropy Roundtable

1150 17th Street, NW, Suite 503
Washington, DC 20036
202/822-8333
www.philanthropyroundtable.org

This national association is founded on the principles that voluntary private action offers the best means of addressing society's needs and that a vibrant private sector is critical to creating the wealth that makes philanthropy possible.

OTHER NONPROFIT SECTOR ORGANIZATIONS

Alliance For Nonprofit Management

www.allianceonline.org

The Alliance for Nonprofit Management is a professional association devoted to improving management and governance in nonprofit organizations.

BBB Wise Giving Alliance

www.give.org

The BBB Wise Giving Alliance provides reporting and advisory service about fundraising and about national nonprofit organizations that solicit contributions from the public. Its purpose is to maintain sound standards in the field of philanthropy and to aid wise giving through advisory reports to the public.

GuideStar

www.guidestar.org

GuideStar's database of 850,000 public charities provides individuals with comprehensive information about charities that match their interests. All charities listed in the GuideStar database are public charities in good standing with the IRS.

InnoNet Toolbox

www.innonet.org

InnoNet helps nonprofit organizations build evaluation knowledge and skills, enhance their capacity to improve and learn through the use of participatory evaluation, and embrace and implement change.

Internet Nonprofit Center

www.nonprofits.org

This website helps donors locate charities in the United States. It also features essays, toolkits, and standards for philanthropy.

PRINT RESOURCES

Accounting

Financial Management for Nonprofits: Keys to Success. Peter Konrad and Alys Novak. Regis School of Professional Studies, 2001. 800/798-4153 or 303/458-4150.

The Financial Responsibilities of Nonprofit Boards. Andrew S. Lang. BoardSource 2003. 800/883-6262, www.boardsource.org.

Understanding Nonprofit Financial Statements. Steven Berger. BoardSource, 2003. 800/883-6262, www.boardsource.org.

Communicating with the Public

"Three Key Components to Foundation Communication," *Foundation News & Commentary*, January/February 1999. Council on Foundations members can read the full article online. Go to www.foundationnews.org and click on Issue Archive, January/February 1999.

Conflict of Interest

Managing Conflicts of Interest: A Primer for Nonprofit Boards, Second Edition. Daniel L. Kurtz, Sarah E. Paul. BoardSource, 2001. 800/883-6262, www.boardsource.org.

Governance

Nonprofit Governance Series. BoardSource 2003. 800/883-6262, www.boardsource.org.

Nonprofit Governance: Steering your Organization with Authority and Accountability. Berit M. Lakey. BoardSource, 2007. 800-883-6262, www.boardsource.org.

The Nonprofit Board Answer Book. BoardSource and Jossey-Bass, 2007. 800/883-6262, www.boardsource.org.

Succeeding With Consultants. Barbara Kibbe and Fred Setterberg for the Foundation Center, 1992. 800/424-9836, www.fdncenter.org.

Grantmaking

Grantmaking Basics I and II. Council on Foundations, 1999. 888/239-5221, item # 508. www.cof.org/publications.

"Best of the Worst Practices," *Foundation News & Commentary*, March/April 2000, page 31, www.cof.org/foundationnews/0300/coverstory.htm.

Best Practices in Grants Management. Council on Foundations, 2001. 888/239-5221, item # 509, www.cof.org/publications.

Investing

2006 Investment Performance and Practices of Community Foundations. Council on Foundations, 2007. 888/239-5221, item # 960, www.cof.org/publications.

Minding the Money: An Investment Guide for Nonprofit Board Members. By Robert P. Fry. BoardSource, 2004. 800/883-6262, www.boardsource.org.

Program-Related Investment Primer. Council on Foundations, 1993. 888/239-5221, item #505, www.cof.org/publications.

Legal Issues

First Steps in Starting a Foundation, Fifth Edition. Council on Foundations, 2002. 888/239-5221, item # 101, www.cof.org/publications.

Grants to Individuals by Community Foundations, Third Edition. Council on Foundations, 2004. 888/239-5221, item # 930, www.cof.org/publications.

How to Calculate the Public Support Test, Third Edition. Council on Foundations, 2006. 888/239-5221, item # 970, www.cof.org/publications.

Community Foundations and Agency Endowments. Edward J. Beckwith and David L. Marshall of Baker & Hostetler LLC. Council on Foundations, 2001. 888/239-5221, item # 931, www.cof.org/publications.

Donor-initiated Fundraising: Issues and Guidelines for Community Foundations, Third Edition. Jane C. Nober. Council on Foundations, 2006. 888/239-5221, item # 925, www.cof.org/publications.

Self-Assessment

Self-Assessment for Community Foundation Boards: Online Tool. BoardSource, 2000. 800/883-6262. www.boardsource.org.

The Drucker Foundation Self-Assessment Tool: Process Guide and Workbook. Drucker Foundation and Jossey-Bass, Inc., 1999. 800/956-7739.

The Inclusive Community: A Handbook for Managing Diversity in Community Foundations. Council on Foundations, 1992. 888/239-5221, item # 910, www.cof.org/publications.

Staff

Assessment of the Chief Executive. Revised Edition. Joshua Mintz and Jane Pierson, BoardSource, 2005. 800/883-6262, www.boardsource.org.

Foundation Staffing. The Foundation Center, 2000. 800/424-9836, www.fdncenter.org.

Interviewing: More Than a Gut Feeling, by Richard S. Deems, Ph.D. American Media Publishing, 1998. 800/262-2557.

2006 Grantmakers Salary and Benefits Report. Council on Foundations, 2005. 888/239-5221, (book item #225) (CD-ROM item #224), www.cof.org/publications.

Trends

Foundation Management Series, Twelfth Edition, Volumes I–II, Foundation Governing Boards and Administrative Expenses in Private Foundations. Council on Foundations, 2006. 888/239-5221. Item #228, www.cof.org/publications.

WEB RESOURCES

Accounting

American Institute of Certified Public Accountants, www.aicpa.org

Grants Management Software

The Arlington Group, www.arlingtongroup.com

Bromelkamp Company, www.bromelkamp.com

CyberGrants, Inc., www.cybergrants.com

Digital Footbridge, www.digitalfootbridge.com

Dyna-Quest Technologies, www.Dyna-Quest.com

MicroEdge, Inc., www.microedge.com

Insurance

Director's and Officers Liability Insurance and Indemnification, Second Edition. www.cof.org/publications.

Health Insurance Association of America, www.hiaa.org

Investment

The Investment Fund for Foundations, www.tiff.org

National Committee on Planned Giving, www.ncpg.org

IRS

IRS Information for tax-exempt organizations, www.irs.ustreas.gov/charities/index.html

Job Postings

Action Without Borders, www.idealists.org

Chronicle of Philanthropy, www.philanthropy.com/jobs

Council on Foundations, www.cof.org/network

Foundation Center, www.fdncenter.org/pnd/jobs

Lawyers

American Bar Association, www.abanet.org

Lawyer Locator, www.martindale.com/locator/home.html

Technology

HandsNet, www.handsnet.org

Management Assistance Project, www.mapnp.org

Nonprofit Software Index, www.npinfotech.org

Npower, www.npower.org

Technology Affinity Group, www.tagtech.org

Techsoup, www.techsoup.org

T H E G U I D E F O R
**COMMUNITY
FOUNDATION**
B O A R D M E M B E R S

Serving on a community foundation board is one of the most exciting journeys a nonprofit volunteer can undertake. As a board member, you are not only an advisor but a fundraiser and grantmaker. This guide will give you answers to such questions as: What is a community foundation and how does it work?

How is a board structured? How is community foundation board service different from being on any other kind of nonprofit board? What are a board member's legal, ethical, and social responsibilities?



Formerly the National Center for Nonprofit Boards

1828 L Street, NW, Suite 900
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