CAPACITY BUILDING AND OVERSIGHT BEST PRACTICES

NOT-FOR-PROFIT VENDOR REVIEWS
MAYORS OFFICE OF CONTRACT SERVICES

1) Not-for-profit organization has effective and dynamic governance structure

a) At least two-thirds of the Board is comprised of independent directors who are not compensated as employees or independent contractors, do not receive any material benefits from the organization, except as a member of the charitable class served by the organization, and are not related or reside with any person described above. If an employee does serve as a Director on the Board, they do not vote on their compensation or benefits.

- Staff members can legally serve on boards, however Board Source recommends that no more than one staff person serves as a voting member of the board and should not serve as the chair or treasurer.
- All directors of nonprofit organizations have a “duty of loyalty” to put the best interest of the nonprofit above their own interest. The Panel on the Nonprofit Sector suggests that individuals who have a personal financial interest are less likely to give unbiased consideration to important decisions they must make on behalf of the organization.

b) The Board of Directors meets regularly; the number of meetings per year is not less than the number of meetings stated in the by-laws of the corporation. In order to provide regular oversight, the Board of Directors is recommended to meet a minimum of 4 meetings during a 12 month period.

- Board Source notes that the amount of meetings should be based on the amount of work to be done and how efficiently the meetings are organized. Additional judgments can be based on organizational size, and the amount of committee work being done.
- The Panel on the Nonprofit Sector states that while many charitable organizations find it prudent to meet at least three times a year, some with strong committee structures hold only one or two meetings of the full board each year.

c) A quorum is in attendance at all board meetings. If members participate by conference call or a form of online communication that allows all members to hear and be heard by all other participants the governing documents should specify that such alternative methods of holding meetings are permitted.

- Idealist notes that it is good practice for a board to have at least 1-2 in person meetings per year with a quorum. Additionally boards that meet and/or pass resolutions through conference call, web conferencing, etc should have a policy or made a resolution to do so.

d) A Board of Directors has enough members to deliberate effectively on organizational matters. Board members have the diverse backgrounds, experience and organizational and financial skills necessary to advance the organization’s mission. It is recommended that boards include Directors with programmatic experience, legal and management backgrounds, and at least one Director has financial and/or accounting expertise.

- The Panel on the Nonprofit Sector emphasizes the need for diverse boards that are able to fully deliberate on organizational matters and suggests that the Board should have at least five members, in most cases.
- One of the “Standards for Charitable Accountability” published by the Better Business Bureau Wise Giving Alliance is a board of directors with a minimum of five voting members.

- Community Works states organizations should maintain diverse boards that are able to carry out the needs of the organization.

e) Board minutes are written and circulated to board members for their review and comments following a board meeting and are approved by a vote at the following meeting of the Board of Directors. Minutes record actions of the Board and dissenting votes.

- The Attorney General's document "Right from the Start" for Directors and Officers of not-for-profit organizations recommends that directors should read the minutes of prior board meetings and confirm that his or her votes are accurately recorded, particularly dissenting votes, in order to properly exercise their duty of care.
- Board Source recommends that organizations should share their minutes before meetings in order to inform absent board members and increase effectiveness of meetings.

f) All board officers have been oriented to their legal and ethical responsibilities as nonprofit directors. If needed, organizations should locate and provide specialized training or advice on legal and financial issues and responsibilities.

- The association for leadership notes that board members carry legal responsibilities upon becoming board members. It is in a board members interest to request information (if not given) on the organizations finances and records before agreeing to join.
- The Panel on the Nonprofit Sector states that an effective board orientation process enables board members to carry out their oversight functions effectively by providing oral and written instruction regarding the governing documents, finances, program activities and governing policies and practices of the organization.

g) The compensation of any board member is approved by a majority of the entire board of directors. The number of compensated board members is minimal and members compensated beyond expense reimbursement do not serve as the chair/president or treasurer.

- The Better Business Bureau Wise Giving Alliance standards include that not more than one or 10% (whichever is greater) directly or indirectly compensated person(s) should serve as voting member(s) of the board and compensated members should not serve as the board's chair or treasurer.
- Board Source notes that less then 2% of non profits give any compensation to board members. Board compensation of any kind is permissible only if the board has voted on it or if the by-laws specifically allow for it.
- The Panel on the Nonprofit Sector states that Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. A charitable organization that provides compensation to its board members should use comparability data to determine the amount to be paid, document the decision and provide full disclosure of the amount and rationale for the compensation.

2) Not-for-profit organization has appropriate internal controls

a) Organization has an effective policy or written procedure governing financial transactions including writing and depositing checks, handling petty cash and overseeing the use of credit cards, that are reviewed and provided to all directors, trustees, employees and volunteers that include the following provisions:

(1) Two original signatures are required on checks over a certain amount or in situations where oversight is lacking.

- Risk Digest notes that independent auditors will often recommend nonprofits adopt a two-signature rule, especially when volunteers are handling checks. When establishing a new account or when changing signature authorizations on existing accounts, banks require account holders to sign a waiver that releases the bank from any liability for paying a check with only one signature. Organizations that wire money and/or have electronic accounts are not protected through a two-signature rule and should consider additional controls if substantial transactions are done by such means.

(2) The amount of petty cash that can be withdrawn in a specified period is restricted, and receipts are required to be submitted for all petty cash expenditures and credit card purchases.

- The Alliance for Nonprofit Management recommends that nonprofit organizations set up a fund for petty cash that lasts for a period of one month. Operation of petty cash accounts should require receipts and have a maximum withdrawal amount.

(3) The Board of Directors approves the opening and closing of corporate credit cards, and savings, checking and investment accounts.

- The Alliance for Nonprofit Management notes that the approval/dismissal of bank and investment accounts should be voted on by the board of directors, this practice allows the board to have proper oversight over the financial operations of the organization.

(4) Organization reconciles its bank accounts and credit cards on a monthly basis.

- The New York State Charities Bureau document "Internal Controls and Financial Accountability" states that receipts and expenditures should be compared with the budget on a monthly basis, highlighting the importance of monthly reconciliations.
- The Panel on the Nonprofit Sector argues that complete, current and accurate financial records are essential for not-for-profit boards to exercise appropriate fiscal oversight.

b) Organization uses an automated payroll service or system.

- Having an automated system is a best practice. It increases efficiency, frees up personnel to work on more strategic initiatives and generally provides a more reliable audit trail.
- The Community Resource Exchange recommends hiring a payroll service to ensure that employee withholding taxes are paid on time and the required quarterly reports are filed with the IRS and the state.

c) Financial records are securely kept and are backed up off-site.

- It is a best practice that financial information is handled only by those who are authorized i.e. blank checks and ledgers should not be accessible. Small organizations without large amounts of space can lock these documents and create restrictive access to documents that are kept electronically. This practice ensures accountability of those who handle the documents and prevents possible fraud and misuse from others.

d) Responsibilities for recordkeeping and authorization for each transaction are performed by separate people.

- Guide Star notes that those who are in charge of recording transactions on accounts should not execute or authorize them.
- The Panel on the Nonprofit Sector recommends that no one person bears the sole responsibility for receiving, depositing, and spending its funds.

3) Board conducts careful operational and financial oversight

a) Organization's current budget was approved by a quorum of the Board and is sufficiently detailed as to projected income and expenses for major program activities, fundraising and administration so as to allow Board members to understand the finances of the organization.

- The Better Business Bureau Wise Giving Alliance standards include a board-approved budget for the current fiscal year, outlining projected expenses for major program activities, fundraising, and administration.
- The Free Management Library states that nonprofit boards should approve yearly budgets and financial statements, approving a set of fiscal policies (guidelines for managing the nonprofit's finances), reviewing results of a yearly audit conducted by an outside auditor, review financial reports during board meetings, co-sign checks that are over certain limits, and approve contracts. The board's oversight increases an organization's system of accountability.

b) Board members review required forms and reports including IRS Form 990, NYS CHAR 500, etc. and ensure the organization is in legal compliance with filing requirements.

- The Attorney General's document "Internal Controls and Financial Accountability for Not-for-Profit Boards," states that care must be taken to ensure that the annual IRS 990 truly represents the organization and the filing should be carefully reviewed before they are signed by the management.

c) Board has a finance committee and if the budget is larger than $1 million, Board has an independent audit committee or functional equivalents.

- The Attorney General's document "Internal Controls and Financial Accountability for Not-for-Profit Boards," states that an audit committee is crucial to the governance of a not-for-profit organization and should be composed of directors who are independent of any financial interest in the organization and at least one of whom has expertise in accounting. The audit committee is responsible for selecting and reviewing the independent external auditor and the reports produced by the CPA; reviewing the management letter and discussing recommendations to address anything identified in the letter; understanding and evaluating the organization's internal controls; and monitoring any legal matters and/or investigations that may affect the organization.
- Finance committees are established to ensure organizations are in good financial health. The Guide to Nonprofit Corporate Governance notes that organizations of a "substantial size" will benefit by having an audit committee. Other board members will have enhanced knowledge from the committee which will be able to deeply understand the financial workings of the organizations.

d) Finance committee tracks and reports budget performance and cash flow at each committee meeting.

- Board source notes that Finance committees should "monitor implementation of the approved budget on a regular basis and recommend proposed budget revisions; recommend to the Board appropriate policies for the management of the Corporation's assets" The finance committee has the responsibility of helping the entire board to fulfill its fiduciary duties and to also assist the executive director in review of the organizations financial strength. Tracking reports, budget performance and cash flow helps fulfill this responsibility.

e) Treasurer reports to the Finance Committee and presents the budget performance and cash flow statements to the Board of Directors at each meeting. Treasurer and President have financial expertise.

- The Alliance for Nonprofit Management notes that finance committees often serves as a consultative committee for nonprofit board treasurers. Having the committee serve this function allows the committee to receive information efficiently and assist the treasurer with needed preparation of documents for the entire board.

f) Board evaluates the performance and approves the compensation package of the chief executive.

- "Board Structure and Executive Compensation in Nonprofits" notes that there are strong links between the powers of executives to determine their own salaries and pay rates. As a result, organizations should institute board approval as a standard for oversight purposes.
- The Panel on the Nonprofit Sector and should conduct such an evaluation prior to any change in that officer's compensation, unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living.
- The Panel of the Nonprofit Sector recommends that the governing documents of an organization require the full board to hire, oversee and evaluate the performance of the chief executive officer of the organization, and to approve the compensation of the chief executive in the context of comparable organizations' compensation of such executives. Evaluation and compensation reviews should generally be annual, and should take place in advance of any change in compensation, unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living.
- The National Nonprofit Network suggests the board evaluate the executive director according to the organization's strategic plan or as addressed in the previous evaluation. The Network states that annual reviews allow the board to gather information needed to reward or re-align performance standards and uncover emerging issues.
- The Attorney General's document "Right from the Start" states that board members should be involved in the selection and periodic review of the organization's Chief Executive Officer, Chief Financial Officer, and other key employees in order to exercise their duty of care.

g) Board oversees the chief staff person's expense account.

- The Alliance for Non-profit Management recommends that executives submit expense reports for all allocated expenses on a timely basis. Special accounts are not recommended for an executive without oversight on the account.
- The detailed guidance provided in IRS Publication 463: Travel, Entertainment, Gift and Car Expenses should serve as a guide in avoiding lavish, extravagant or excessive expenditures.

h) Transactions in which any board or key staff member has a conflict of interest are fully identified as to the nature of the conflict, the transaction is approved by a quorum of the board and the Board or staff member with the conflict recuses themselves from the vote.

- The Attorney General's document "Right from the Start" for Directors and Officers of not-for-profit organizations recommends that the board should have a written "conflict of interest" policy that provides for written disclosure of anticipated or actual conflicts, or the appearance of such, in order to properly exercise the duty of loyalty. The board has the responsibility to examine any transaction that is not fair and reasonable, and transactions involving conflicts should be fully documented in the board's minutes. The board should make sure there is a conflict of interest and code of ethics policy in place and that it is updated annually.
- The Panel on the Nonprofit Sector recommends that organizations establish and enforce a conflict-of-interest policy that requires full disclosure of all potential conflicts of interest that

applies to any person who has the ability to influence decisions of the organizations. All board and senior staff members should be required to sign it and disclose any material conflicts of interest, both at the time they join the organization and at the beginning of each fiscal year. Board members with a material conflict of interest should be required to recuse themselves from board discussions and votes regarding those matters, other than to respond to requests for information.

i) A policy controlling the employment and compensation of family members of directors and key employees.

- The hiring and compensation of family members could be an actual or perceived conflict of interest. The Minnesota Council of Nonprofits notes that nationally it may not be illegal to hire or compensate family members as directors; however this should be stipulated in an organization's By-Laws or conflict of interest policy. The council also notes that the majority of board members should be unrelated.
- A policy prohibiting the hiring of any individual if a member of that individual's immediate family is employed in an administrative capacity in the organization or is a member of the governing board is legally required in any organization that receives Federal discretionary grants, including Head Start discretionary grants, under the HDS Grants Administration Manual.

j) The not-for-profit has a policy or procedure to ensure loans are repaid if the organization provides loans to line staff between pay periods. Loans to employees over a significant dollar value are reported to or approved by the Board of Directors. Organizations do not loan funds to key employees, directors, officers, or trustees.

- The Chronicle of Philanthropy notes that organizations should not give loans disproportionate to their charitable expenditures. The chronicle also recommends that organizations should not carry significant debt as a result of loans to employees. Board members and executives should not receive loans from their respective organizations in most circumstances.
- The Panel on the Nonprofit Sector agrees that loans to directors, officers, trustees and executives have created both real and perceived problems for charities. When an organization deems it necessary to provide a loan to an employee, the Panel recommends that the terms be clear, approved by the Board and reported on the 990.
- The "intermediate sanctions" excise tax provisions under Section 4958 of the Internal Revenue Code impose steep penalties on transactions, including loans, which provide excess benefits to disqualified people, who have substantial control over the organization.

k) Organization has implemented a whistleblower policy and designated a Board Committee or member who can be contacted and informed of any misconduct.

- The Panel on the Nonprofit Sector recommends that organizations should establish and implement policies and procedures that enable individuals to report information on illegal practices or violations of organizational policies. Policies should specify the board and staff members within the organization or outside parties to whom such information can be reported without threat of retaliation.
- The Attorney General's document "Right from the Start" suggests that boards should have a policy regarding disclosure and identification of fraud and should make sure that a policy for records retention and whistleblower protection is in place in order to exercise their duty of care.