The Role of the Board of Directors in Financial Oversight

A Guide for Board Members

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I. Introduction: What is Financial Oversight?

While managing a nonprofit's day-to-day finances is the job of an organization's senior management, the organization's board of directors has ultimate responsibility for overseeing the organization's financial affairs. This important board duty—the duty of financial oversight—encompasses an array of responsibilities, from establishing the CEO's compensation, to approving the annual budget, to assessing whether the organization should diversify its income stream. Broadly speaking, a board of directors' financial oversight duties include:

- Establishing and ensuring the organization's compliance with proper financial systems and controls;
- Regularly evaluating the organization's financial health; and
- Ensuring that the organization is on a financially sustainable path.

In performing its oversight role, the board exercises an important check and balance on senior management's activities. The board must be able to see the "big picture," recognizing when a small financial discrepancy can become a major liability or when a lag in fundraising points to a larger issue in the organization's ability to solicit donations. Active, independent oversight is essential to ensuring the organization's current and future financial stability, as well as proper stewardship of the organization's assets.

II. Effective Board Oversight: Laying the Foundation

When establishing a nonprofit board or nominating new directors, it is important to consider board composition. How many directors should serve on the board? What skills should they possess? To establish a board able to perform its financial oversight role effectively, the following should be considered:

A. **Board Size:** A nonprofit board should have an appropriate number of members to conduct effective oversight. A board with too few members may not have sufficient resources to be effective, while an overly large board may result in individual directors feeling less responsibility for oversight of the organization's financial affairs. While some nonprofits establish large boards to help with fundraising, most organizations benefit from smaller, more effective "working" boards.

B. **Director Independence:** A director with a personal interest in a transaction may exert influence that ultimately undermines his or her role in ensuring the organization's financial soundness. For example, if the director supplies goods or services to the nonprofit, there is a risk that the director may be awarded a contract on terms more favorable (and accordingly, less favorable to the organization) than terms that would be obtained from an unaffiliated third party. There is also a risk of more indirect influence: for example, a director may not voice his or her dissent to improper board actions for fear of losing a customer. To

guard against this risk, a majority of directors on the board should be independent. The presence of independent directors helps ensure that the board makes objective, unbiased decisions that are in the best interest of the organization.

A nonprofit director is considered independent provided neither the director nor a close family member:

- Receives compensation from the organization;
- Is affiliated with management; or
- Has a personal interest in a specific transaction.

Organizations should also institute a conflict-of-interest policy so that directors with personal interests in specific transactions are excluded from decision making on those matters. Board minutes should take note of such an exclusion to ensure the fairness of the decision-making process is documented.

C. **Board Financial Literacy:** Not every board member needs to be a financial whiz, but every board should include some members with business or finance experience. Moreover, *all* board members should possess enough financial literacy to understand basic terminology, read and evaluate financial statements, and be able to ask the right questions in determining the financial health of the organization. Such questions might include:

- Does the organization's budget support its strategic plan?
- Are the organization's cash-flow projections realistic?
- Is the organization complying with requirements established by the funders?
- Does the organization have proper policies in place to prevent error, fraud, and abuse?

By ensuring that all board members have the capacity to probe for and recognize financial warning signs, an organization significantly reduces the risk that the nonprofit will face a sudden budget shortfall or unexpected expense, be blindsided by accusations of financial impropriety, or find itself unable to fulfill its long-term goals because of a mismatch between the budget and the strategic plan. Training can be provided to board members to ensure that they have the skills needed to do this job.

D. **Board Committees:** Board members with expertise in business or financial management may be asked to join board committees that draw on their skills for specific purposes. For example, while the annual budget generally requires full board approval, a finance committee may be tasked with reviewing the organization's monthly or quarterly financial reports to ensure that the organization's budgeted costs and income are on track. Similarly, an audit committee may be in charge of overseeing an organization's annual independent audit, while a fundraising committee may be created to research and recommend

new sources of funding. By delegating areas of financial responsibility, the board can capitalize on the specific expertise of individual board members.

III. Board Oversight Responsibilities

Board financial oversight encompasses many and varied responsibilities. Below is a list of the key responsibilities board members should assume.

A. **Establishing Financial Controls:** While day-to-day accounting and financial decisions are the responsibility of management, the board must establish the framework in which management operates, creating policies that prevent error and fraud. Such policies include:

- **Separation of Duties:** As a fraud-prevention measure, the board should require that different employees are responsible for such tasks as authorizing payments, disbursing funds, reconciling bank statements, and reviewing credit card statements. At least two people should bear responsibility for depositing, recording, and reconciling the receipt of funds. A senior manager should approve all vendor or consulting contracts that are awarded following a transparent procurement process.

- **Signatures and Authorizations:** Similarly, a policy requiring two layers of approval for expenses will reduce the risk of embezzlement. Boards should establish policies requiring two signatories on every check over a specified amount and two different signatories on every authorization or payment. Checks should never be pre-signed, and proper invoices should accompany any payment or disbursement. Require prior written approval for large checks or credit card charges, again from two individuals, with documentation demonstrating the legitimacy of the expense.

- **Good-Governance Policies:** Good-governance policies can also play an important role in ensuring the organization's financial health by promoting a culture of accountability that will prevent future problems. Such policies include:

  - A **conflict-of-interest policy** to guard against self-dealing transactions.

  - A **document retention policy** to protect against loss or inadvertent destruction of documents.

  - A **code of ethics** to establish conduct guidelines for board, management, staff, and volunteers.

  - A **whistleblower policy** that protects staff and volunteers who report unethical or unlawful practices within an organization.

A Few Words about Restricted Versus Unrestricted Funds

Nonprofits follow what is known as "fund accounting"—an accounting practice that allocates revenue into one of three funds:

- **Unrestricted Funds:** These funds are free from any donor restrictions and may be used by the nonprofit in any manner consistent with its mission, including general operating expenses. Many smaller contributions and program related revenue, such as workshop fees, are unrestricted.
- **Temporarily Restricted Funds:** These funds may only be used in the manner specified by the donor at the time the donation was made. Donor-imposed restrictions can take one of two forms:
  - The passage of a specified period of time (time restriction); or
  - The performance of certain activities specified by the donor (purpose restriction).

  These funds most often come from a foundation or government grant that is intended to fund a specific project or as a major gift from a donor for the purpose of supporting a particular program or fundraising campaign.
- **Permanently Restricted Funds:** These funds are restricted by the donor for a designated purpose or time period that will never expire. In such cases, the principal balance of the contribution remains invested, and only earnings on the principal may be used, such as with an endowment. The purposes for which the earnings may be used may also be restricted, such as a donation used to create a permanent scholarship fund.

The board is responsible for ensuring that the nonprofit's funds are used in a manner consistent with any donor restrictions.

B. **Ensuring Compliance With Policies and Procedures:** Once financial policies and procedures have been established, the board (or a board committee) must verify that employees and volunteers are complying with these policies and procedures by reviewing regularly conducted reports, as well as the independent auditor's annual letter reviewing management's accounting practices. The board should also periodically review and revise the policies and procedures to ensure that they are effective and up to date.

C. **Budget Approval:** An organization's management is responsible for creating an annual budget, which lays out the organization's projected income and expenses for the upcoming year and serves as a framework for program management and overall administrative decisions. The board is responsible for reviewing and approving the budget. In its oversight function, the board should examine the budget to ensure that the projected expenses and income are comprehensive and realistic, based on the organization's prior financial performance and general economic conditions. The board may send the budget back to management for revisions if it determines that changes are needed.

Cash Flow and Budgeted vs. Actual Expenses and Income: The board (or a board committee) should receive regular monthly financial reports (or quarterly reports, in the case of smaller organizations) that show budgeted and actual expenditures, as well as budgeted and actual revenues. The reports should also indicate which funds are restricted and which are unrestricted. By examining financial statements regularly and comparing actual figures to the projected ones, the board can verify that the budget is on track, question any major variances, and determine

whether adjustments must be made in spending to accommodate changes in revenue. For example, if an anticipated donation does not come through, the board can instruct management to carry out expense-cutting measures or seek other sources of funds.

In addition, it is important that the board maintain a clear picture of the timing of expected donations and expenditures. An organization may incur expenses at times that are different from when it receives its donations. It is the board's responsibility to ensure that the organization has sufficient cash on hand to pay its operating expenses, such as salaries, payroll taxes and out-of-pocket costs, in a timely manner throughout the year. The organization can meet this need by establishing cash reserves to cover its expenses or by obtaining a line of credit with a bank so that it can draw on the line when cash is low, and repay it later in the year.

For example, suppose an organization runs a summer recreational program for inner city youths. The organization has certain overhead expenses, such as rent, insurance, utilities, and management salaries. Its expenses significantly increase during June, July, and August because of the cost of operating the summer program, including salaries for summertime employees, recreational equipment, cost of outings, and children's meals. The organization is funded largely through individual donations, more than half of which are made in the six weeks between Thanksgiving and year's end. Very few donations are made during the summer months, when the organization's costs are highest. As a result, even though the organization will raise enough money by December 31 to meet its annual expenses, it struggles to pay its bills during the summer.

In order to deal with the summer shortfalls, the board ensures that the organization establishes cash reserves to cover many of its summer expenses, and it approves a line of credit with a bank to meet the remaining costs. In accordance with its budget, the organization repays the line of credit and replenishes its reserves in December, after it receives the bulk of its contributions.

D. **Ensuring Financial Sustainability:** In addition to verifying that the organization is meeting its budget targets, the board should look beyond periodic financial reports to consider how the organization's current financial performance compares with that of previous years, and how its financial future appears. If the organization's net assets decline over a period of years, or if future funding seems likely to decrease significantly, the board will need to take steps to achieve or maintain the financial stability of the organization. The board should engage in strategic financial planning and decision making to assess how well the organization's programs and fundraising work together, how the organization's goals and needs may evolve, and how the cost of changing needs may be met in the future. The board should also evaluate the organization's reserves in the event of a funding shortfall or an unanticipated rise in costs, and investigate the risks

and benefits of exploring new funding streams. This will help position the organization for long-term sustainability.

E. **Role of the Audit Committee:** The board should create an audit committee composed solely of independent directors, at least one of whom has financial expertise. The audit committee should assume responsibility for reviewing the organization's financial disclosure statements to the Internal Revenue Service—the Form 990, 990-EZ, or 990-N, as well as the Form 990-T (for unrelated business income tax), along with any reports required by states or the District of Columbia. Ideally, the work of preparing these reports will be conducted by an independent accountant selected by the audit committee, and the reports will subsequently be reviewed by the committee and by the full board.

   The audit committee is responsible for selecting an independent financial auditor to conduct an annual audit of the organization's books and records. The audit committee can either be authorized by the board to make the final decision with respect to who will audit the organization's books, or it can recommend that the board retain the services of an auditor, subject to the board's approval. An independent audit can be invaluable in highlighting weaknesses in an organization's financial systems, helping to strengthen policies and procedures, and contributing to a culture of transparency. Prior to the start of the audit, the committee should meet with the independent auditor to discuss the scope of the audit. The audit committee is also responsible for supervising the audit and resolving any disputes on how best to account for the finances of the organization that may arise between the auditor and management. The audit committee should also request and review the auditor's management letter. This letter sets forth the auditor's findings regarding the accounting processes and procedures used by management. Finally, the audit committee should meet with the independent auditor and review the results of the audit before it is presented to the full board.

   While an independent audit is not required for federal tax reporting, it is a good-governance practice that lends credibility to the organization. In addition, a number of states require tax-exempt organizations to have an annual audit performed by an independent accountant as part of the organization's registration under the state's charitable solicitation laws.

F. **Compensation of Management:** The board is responsible for establishing the compensation for the CEO and other members of senior management. The Internal Revenue Code (IRC) sets forth the criteria for determining who is a member of senior management and provides that a nonprofit organization cannot pay more than "reasonable" compensation to them. If an organization pays excessive compensation, then the employee who receives the excess payment must return it to the organization, and the employee and the board members who authorize it will be subject to penalty taxes on the amount of excess pay.

To avoid the penalty tax on any payment intended as compensation, the nonprofit organization must also report the payment as compensation on its federal tax forms or have the employee do so, unless the nonprofit reasonably believed that the payment was exempt from tax.

> *For example, suppose an organization hires a new executive director and agrees to pay a lump sum amount to offset some of the executive director's relocation expenses. The tax law provides that, because the amount is a lump sum payment of cash which the executive director may, but is not required to, spend on relocation expenses, and not a reimbursement for actual, documented relocation expenses incurred by the new executive director, it should be taxable to the employee. However, the organization fails to report it as taxable compensation on the executive director's W-2 or on the organization's Form 990. The employee does not report the payment as income on Form 1040. No other documentation exists to show that the payment was intended to be treated as taxable compensation. The payment is considered an excess benefit transaction, even if it was reasonable for the organization to pay the new executive director's relocation expenses. As a result, the executive director must return the payments to the organization and pay a 25 percent penalty tax to the IRS on the amount of the transaction.*

To avoid harsh penalties for paying excess compensation, the board should follow the IRC's process for establishing the presumption that the compensation is reasonable. If the organization follows the steps below, the IRS will have the burden of proving in court that the compensation is unreasonable.

1. The board (or a committee of the board) must approve the amount of compensation in advance.
2. When approving the compensation, no director should have a conflict of interest. Any board member with a conflict of interest must disclose it to the other directors, and directors with conflicts may not participate in the vote or discussions of management compensation. A conflict of interest exists if:
    - A director is participating in, or economically benefiting from, the compensation arrangement being voted on, or the director has a family member[1] benefiting from the compensation arrangement;

[1] Family members include spouses, parents, siblings and their spouses, children and their spouses, grandparents, great-grandparents, grandchildren, and great-grandchildren and their spouses.

- A director is an employee subject to the direction or control of a member of management whose compensation is being voted on;
- A director receives compensation or other payments that must be approved by a member of management whose compensation is being voted on;
- A director has a material financial interest that would be affected by the compensation package being voted on; or
- A director votes on a compensation package for a member of management, and that member of management has approved, or will approve, a transaction providing economic benefits to the director.

3. The board (or committee) must make use of comparability data that shows how much similar organizations are paying employees with similar job titles, expertise, and experience to determine that the compensation is reasonable.
    - Comparability data is appropriate if it provides the board with sufficient information to determine if the compensation arrangement, in its entirety, is reasonable when compared to what other organizations pay. The board should consider:
        - The actual compensation paid by similarly situated for-profit and nonprofit organizations for comparable positions;
        - Whether or not there is a ready supply of qualified prospective applicants in the area;
        - Current compensation surveys compiled by independent firms; and
        - Actual written offers from similar institutions competing for the services of the senior manager.
    - To obtain comparability data, the organization may hire a consultant to review the organization's compensation structure, or may purchase compensation comparability data from organizations that provide technical assistance to other nonprofits or from human resource companies that compile that information for a fee. The organization can also use publicly available information on Web sites such as www.guidestar.org to determine what comparable organizations are paying their employees. Organizations with less than $1 million in revenue should rely on at least three comparable organizations. Larger organizations will typically rely on 5–10 organizations.
    - The board must have a clear understanding of which organizations qualify as "peers" for purposes of making comparisons. A peer

organization should be similar in size and mission and should be located in the area where the organization is located. For example, if the organization is located in the Washington metropolitan area, the peer organizations should be located in that area. If there is not a ready supply of people to perform similar services in the immediate geographic area in which the nonprofit is located, the organization may look at similar organizations in a larger geographic area and adjust its determination of comparability accordingly.

- Peer organizations may be different for different positions. For example, a health care organization would typically recruit medical staff from other health care organizations, and would look at those in developing a peer group. At the same time, the health care organization may need to recruit a finance or IT director from other types of nonprofits, and may want to base the comparison on those groups.

4. The decision-making process must be properly documented.

    - Documentation of the decision-making process must be in written or electronic form, such as written minutes or an e-mail summary of the meeting at which the compensation is approved. The documentation must note:

        - The terms of the compensation package and the date it was approved;

        - The members of the board (or committee) present when the compensation package was debated, and those who voted on it;

        - The comparability data obtained and relied on by the members of the board and information on how the data was obtained; and

        - Any actions taken by a regular member of the authorized body who had a conflict of interest with respect to the transaction (e.g., did the member leave the meeting and refrain from taking part in the decision?).

    - The documentation must be completed before either the next meeting of the board or committee, or 60 days after the final action or actions are taken, whichever is later. The board or committee must also review the documentation and make any needed corrections to the documentation within a reasonable amount of time.

G. **Financial Reserves and the Prudent Investment of Financial Assets:** In its oversight of the financial sustainability of the organization, one of the board's most important goals is maintaining adequate financial reserves. A reserve helps

the organization weather difficult financial times, while also allowing the organization to preserve critical services needed by its client population and to maintain credibility within the nonprofit community.

An organization should strive to maintain a minimum reserve comprised of unrestricted assets equal to three months of operating expenses, which include such costs as rent, utilities, insurance, and payroll. However, it is considered a best practice to maintain a reserve of six to nine months of operating expenses. The reserve fund allows the organization to continue its operations, even if an unanticipated financial event occurs.

The board is responsible for establishing procedures for determining when and how the reserve will be used. For example, the reserve should not be used to compensate for a shortfall in projected fundraising, the proper response to which is to cut expenses. Instead, a reserve should be used to cover costs arising from extraordinary events, such as the unexpected loss of a major grant, delayed payments, unexpected building repairs, or a significant economic downturn.

In addition, the reserve should only be used if there is a plan in place to restore the funds used in the near-term future. For example, if there is a delay in the receipt of a foundation grant, it would be acceptable to use the reserve for expenses in the short term, and to then replenish the reserve when the foundation grant is received. However, the reserve should not be used to continue with a project even though further funding has been denied. To use the reserve without any plan to replenish it would cause the organization to operate without a reserve going forward, and a one-time infusion of funds would not ensure the financial viability of the project. If the organization does not have sufficient reserves, the board should ensure that the cost of creating and maintaining a reserve fund is incorporated into the budget on an annual basis.

The procedures for utilizing the reserves will typically depend on the amount and nature of the expense. For management to make small, short-term use of the reserves, it may be sufficient to have the board chair or treasurer sign off on the expenditure. More significant expenditures may require the approval of the finance committee, the executive committee, or the full board.

The Board is also responsible for establishing policies and procedures to ensure that the organization manages and invests its reserve and other funds responsibly and in compliance with the legal requirements. The policies should govern how the funds will be invested, ensure that donor-restricted funds are used in a manner that complies with the donor's stipulations, and allocate the returns from investments among the various programs. For example, the board must decide questions such as:

- Should the organization allow a donor to make a donation which restricts the organization from using anything except the interest earned on the funds, and then only for a specific project?

- Are there any restrictions on how the nonprofit will invest its funds? For example, does the organization wish to invest in companies that manufacture armaments or alcohol, maintain gaming establishments, etc.?

Board members are expected to act in good faith in managing the funds of the organization, using the care an ordinarily prudent person in a like position would exercise under similar circumstances. This means that directors are also responsible for ensuring that those making the investment decisions, including any committee appointed by the board, are acting prudently. Directors should keep in mind several factors in carrying out these duties:

- The needs of the organization and the general economic conditions, including the possible effects of inflation and deflation;
- The expected total return for an investment, including appreciation, and how that affects the overall investment portfolio;
- The need to preserve capital versus the need to generate income;
- Other resources available;
- An asset's special value, if any, to the organization, such as continuing to own property of historic value to the organization; and
- Any expected tax consequences with respect to an investment.

The board may incur reasonable costs in managing the organization's funds.

H. **Fundraising:** Without effective fundraising, even a nonprofit with a critical mission and excellent programs is not guaranteed success or even survival. Thus, the board has a responsibility to attract resources to sustain the organization's programs and fulfill its mission, and to establish a successful fundraising strategy. The board must also ensure that the organization's fundraising complies with ethical guidelines and state laws.

- **Creating a Strategy:** One of the board's most important roles is to define and establish a successful fundraising strategy to sustain the organization's goals. The board must also select and support senior management in charge of fundraising and work closely with them. Even though the board is ultimately responsible for the organization's fundraising strategy, the fundraising activities will not succeed without a close partnership with management. The board must specify the responsibilities of both management and the board in the fundraising effort.

- **Fundraising Practices:** The board should ensure that fundraising practices are ethical and cost-effective, and that fundraising programs reflect well on the organization and mission. This includes properly managing donor-restricted funds, establishing clear standards and procedures for accepting donations, and ensuring that staff or volunteers acting on behalf of the organization engage in ethical fundraising practices and are appropriately compensated. The board is also responsible for ensuring that the organization complies with the state charitable solicitation laws in the states where it conducts fundraising activities.

- **Fundraising Diversity:** Many nonprofits are funded from one or two grants from the government or from a handful of foundations. The nonprofit uses the grants to fund specific projects as well as the organization's operating expenses, with each grant picking up a pro-rata share of the executive director's salary, the rent, etc. However, such a nonprofit runs a real risk that if it loses one of those grants, it will no longer be able to continue its operations. Therefore, it is critical for organizations to develop diversified funding sources.

  It is more common for newer, start-up organizations to rely on just a few sources of funds. It takes time to establish funding resources and develop a program that will appeal to donors. But as the organization matures, it should develop a variety of donor sources. For example, the organization may want to develop a list of individual donors who regularly give to the organization, as well as corporate and foundation donors. It may also want to employ several types of fundraising methods, such as submitting grant proposals, soliciting individual donors, and hosting fundraising events. Another way for an organization to raise funds is to charge a small fee for some of its services, such as training classes, so it can develop a program revenue income stream. Finally, the organization should develop several platforms for giving, such as donor mailing, Twitter or Facebook, a donation button on its Web site, or e-mail solicitations.

  The more diverse an organization's funding sources, the more likely the organization can withstand financial reverses. For example, while corporations often cut back on donations during tough economic times, historically, individual donors have been more likely to increase their donations, because they appreciate that, in a tough economy, more people will need the organization's services.

- **Gift Acceptance Policy:** On occasion, organizations may be offered donations that would compromise the nonprofit's ethics, financial circumstances, program focus, or other interests. For example, funding may be offered from a foundation whose mission is inconsistent with the organization's mission. Therefore, the board must set clear standards and procedures for determining when it will not accept a donation. These policies must be established in advance and not after a questionable gift has been

offered; otherwise, financial and time pressures may cause the board and management to make a wrong decision about whether to accept the gift.

- **Fundraising Techniques:** Engaging in inappropriate fundraising practices can significantly damage the reputation of even well-established and respected nonprofits. Therefore, the board must ensure that individuals or firms that solicit funds on the organization's behalf receive appropriate training and supervision; understand their responsibilities and do not employ techniques that are coercive, intimidating, or intended to harass potential donors.

- **Compensation for Fundraisers:** Payment for fundraising activities should reflect the skill, effort, and time expended by the individual or firm on the organization's behalf. Basing compensation on a percentage of the money raised can encourage fundraisers to put their own interests ahead of the organization's or the donor's, and may lead to inappropriate techniques that jeopardize the organization's values and reputation, as well as donors' trust in the organization. To protect against these risks, the board should establish policies prohibiting commission or percentage-based compensation for internal and external fundraisers.

- **Charitable Solicitation Laws:** Most states and the District of Columbia regulate the solicitation of contributions by charitable organizations. To solicit funds from individuals, foundations, or businesses located in the District, Virginia, and Maryland, as well as in other states, organizations must register with the local government unless they qualify for an exemption. The board is responsible for ensuring that the organization complies with the various charitable solicitation laws.

- **Privacy Policy:** The board should consider establishing a privacy policy that protects individual donors' names and contact information from sale or other disclosure (except where required by law) and offers them an opportunity at least once a year to opt out of the use of their names.

- **Board Participation:** Board members' personal participation is essential to any successful fundraising campaign, as an organization cannot expect others to provide financial support if board members do not. Rather than specifying a minimum dollar amount that each board member donate, a nonprofit should set the goal of 100 percent participation annually by the board. Board members should also help management identify and evaluate prospective donors, whether individuals, corporations, or foundations. Directors should also assist in cultivating prospective donors by stimulating interest in the organization and its work.

I. Assessing and Managing Risk

- **Organizational Risk:** In protecting the organization's assets and ensuring that those assets are available to serve the mission, the board must work with

management to identify activities that create financial and reputational risks for the organization.

- **Mitigating Risk:** As part of its duty to manage the risks facing the organization, the directors should take steps to reduce the risk that a bad event will occur, such as better employee training, the purchase of safety equipment, and the development of more comprehensive procedures.

- **Insuring Against the Risk:** The final step in a risk management strategy is to insure against the risk of loss. The board is responsible for ensuring the organization has adequate insurance against claims by employees, volunteers, clients, and other third parties. In addition, the board should have a plan to deal with risks that cannot be insured against—such as the bankruptcy of a major funder. To deal with such risks, the board must ensure that there are other safeguards in place, such as maintaining adequate reserves.

- **Personal Risk:** Directors may also be subject to personal liability. To protect themselves, directors should exercise their duties with due care and ensure that the organization acts in accordance with legal requirements. A director may also wish to ensure that the organization can pay any attorney's fees he or she incurs and any legal damages for which he or she is responsible in connection with any acts committed while serving on the board (indemnification). The organization may purchase directors' and officers' liability insurance to fund such expenses. Under such insurance, directors will be insured for their legal defense costs if they are sued any settlement for claims covered by the policy, subject to any exclusions in the policy.

IV. Conclusion

No matter how important its mission or how urgently needed its services, an organization whose board fails to perform effective financial oversight can quickly find itself in serious financial trouble. In contrast, an active and attentive board will enhance the organization's current and future financial stability. By continuously evaluating the organization's financial position, reviewing the internal policies and systems that can affect its finances, and by establishing an environment of transparency and accountability. By being willing to ask hard questions and to take a long-term view of the organization, board members will inspire confidence among its funders and supporters and position the organization well for future growth.

V. Additional Resources

D.C. Bar Pro Bono Center: The Pro Bono Center matches nonprofit organizations with pro bono legal counsel. It also hosts training sessions and publishes legal information of importance to nonprofit organizations. www.dcbar.org/ced

BoardSource: BoardSource provides resources for nonprofit leaders through assessment tools, membership programs, training, an extensive Web site, and workshops. It also provides governance consultants who work directly with nonprofit leaders to design specialized solutions to meet an organization's needs. www.boardsource.org

Center for Nonprofit Advancement: The Center assists nonprofits by providing them with education and training, networking, advocacy, and buying opportunities, including health and liability insurance. www.nonprofitadvancement.org