

What Every Board Member and Officer Should Know

A Guidebook for Tennessee Nonprofits



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Dear Tennessee nonprofit officers and board members:

Your service in nonprofit organizations continues Tennessee's great volunteer tradition. Tennessee nonprofit organizations are vital to our citizens, providing important services and opportunities throughout the state. By donating your time and talents to Tennessee's diverse nonprofits, you play an essential role in shaping a brighter future for Tennessee.

We believe the principles and practices in this new Guidebook can enrich your nonprofit experience and strengthen your organization.

We commend you for your service to the people of the great Volunteer State and hope this Guidebook proves to be a valuable resource to you in your efforts on behalf of Tennessee's nonprofit organizations.

Sincerely,

Robert E. Cooper, Jr.
Attorney General and Reporter

Tre Hargett
Secretary of State

Lewis Lavine
President, Center for Nonprofit Management



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This Guidebook has been prepared as a reference tool for you, the members of the board of directors and officers of Tennessee nonprofit organizations. It describes some of your rights and duties as well as issues which you may encounter. Your service should be a rewarding experience. This Guidebook attempts to help you prepare for this service. It is not intended to be a complete summary of the laws governing nonprofits in Tennessee or a substitute for legal advice.

Board Member Responsibilities

Although as a board member you may not manage the day-to-day activities of your nonprofit, you do act as a steward and have certain fiduciary responsibilities under Tennessee law. Specifically, Tennessee law imposes upon you the duty of loyalty and the duty of care.

The duty of loyalty means that you must act with undivided loyalty in the best interests of your nonprofit organization and that you not seek to benefit personally from the business activities of the nonprofit you serve. In the event that you have a conflict of interest between the best interests of the nonprofit and your own interests, you must comply with Tennessee law in resolving this conflict. Actions that benefit you at the expense of your nonprofit are a breach of your fiduciary duty.

The duty of care means that you must act reasonably, as a prudent person in similar circumstances would, that you are familiar with the nonprofit's activities and financial condition, and that you participate regularly in board meetings. It means that you act in good faith and make informed decisions. It is the job of the governing board to oversee the work of the chief executive officer of the nonprofit and to make sure that the organization is faithfully carrying out its charitable purpose without extravagance or waste.

Best practices to assist you in carrying out your responsibilities include:

- Attending board meetings and meetings of committees on which you serve. Make certain that you receive detailed information beforehand about matters that are going to be discussed and voted on at a meeting, especially the financial reports and financial statements of the nonprofit.
- Carefully reading all the material you receive, asking questions, and being active in board discussions. It is important to know how the organization is functioning and understand the specific purposes and mission of the nonprofit. Be informed about every major action that the nonprofit takes, and be proactive about reviewing materials in a timely manner.

- Using your own judgment in voting and not simply following the lead of the chief executive officer, chairperson of the board, or fellow board members. A responsible board member will ask about the reasons for recommending a particular action and the consequences, good and bad, such action will bring.
- Participating in strategic planning activities that assess and plan for the nonprofit organization's future. Ask about the status of the nonprofit's internal controls and about written policies and procedures that protect the nonprofit from error, fraud and embezzlement.
- Inquiring whether the nonprofit has a directors and officers liability policy and whether the nonprofit indemnifies its directors and officers from liability.
- Reviewing board or committee minutes to make certain that the meetings and votes were properly recorded. If there are errors in the minutes, ask for clarifications or changes.

You must act in good faith and in the best interests of your nonprofit organization. Failure to do so can seriously harm your nonprofit. Furthermore, under Tennessee law, you may be personally liable to the nonprofit for the harm it suffers if you breach your fiduciary duties.

Officer Responsibilities

You must act in good faith and in the best interests of your nonprofit organization, and, like a board member, you may be personally liable to the nonprofit for the harm it suffers if you breach your fiduciary duties. In many small nonprofits, officers may also serve as members of the board of directors and, therefore, have the fiduciary duties of board members as well as officers.

Be Engaged

The officers and board members of a nonprofit, even when serving in a volunteer or part-time capacity, must be well-informed, hold regular board and committee meetings, maintain accurate minutes of those meetings, encourage open discussion, and pursue the nonprofit's mission and best interests with determination. One of the responsibilities of a board member is to make certain that the nonprofit operates in a fiscally sound manner, has mechanisms in place to keep it fiscally sound, and is properly using any restricted funds it may have. If, as a board member, you do not have adequate information, you have the right to get it. Officers have the responsibility to provide it.

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Best practices for being engaged include:

- Making certain that a realistic annual budget is developed. Develop the budget early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year. Expect management to produce timely and accurate income and expense statements, balance sheets and budget status reports. Expect to receive and review these in advance of board meetings.
- Making certain that the required annual federal and state reports and tax returns are properly and timely filed with both the Internal Revenue Service and the Tennessee Department of State, as well as other filings that must be made.
- Requiring periodic confirmation from management that employee withholding taxes and insurance premiums are being paid when due.
- Paying special attention to where and how the funds of the nonprofit are being held and invested. Consider creating standing audit and finance committees to regularly review your nonprofit organization's finances and assets. Confirm that restricted gifts are being accounted for separately and that they are being used in accordance with the restrictions applying to them.
- Ensuring that fundraising is done honestly and with integrity. Carefully review contracts with professional fundraisers who are empowered to solicit charitable donations from the public in the nonprofit's name, and inquire into the fundraiser's track record. Make sure that any contract with an outside professional fundraiser is fair and reasonable, and that the fundraiser's performance is monitored. Be aware that the professional fundraisers that the nonprofit uses may be required to register with the Charitable Solicitations and Gaming Division of the Tennessee Department of State and file notice with the division prior to soliciting contributions on the nonprofit's behalf.

Be Informed

In order to carry out your responsibilities as a board member, you must be able to make informed judgments about important matters affecting the daily operation of the nonprofit organization and how it affects the community it serves. The law permits you to reasonably rely on information from the nonprofit organization's staff, its lawyer, its accountant, outside advisors, and board committees in making those judgments. If you don't have adequate information, request and obtain it. Officers have a duty to provide this information to the board.

Best practices to help you be informed include:

- Having a copy of the articles of incorporation and bylaws of the nonprofit and other documents that may be necessary to understand its operations.
- Inquiring about an orientation session for new board members and about a board manual containing the nonprofit's written policies and procedures.
- Requesting reasonable access to management and reasonable access to internal information about the organization.
- Requesting reasonable access to the organization's principal advisors, such as its auditors and consultants on executive compensation.
- Engaging the services of outside advisors to assist the board with a particular matter.

Responsibility for the Chief Executive Officer's Selection and Compensation

A major responsibility of the board of directors is the selection of a qualified chief executive officer, the establishment of that person's compensation, review of that person's performance on an annual basis, and offering criticism, where appropriate. The public, which supports the nonprofit and uses its services, is interested in knowing how their charitable donations are being used and what compensation levels are being paid. This information is publicly available through the Form 990 your nonprofit may be required to file with the IRS. You may obtain the form 990 for those charities registered with the Department of State's Division of Charitable Solicitations and Gaming by contacting the Division at 615-741-2555 or charitable.solicitations@tn.gov. Form 990s are also publicly available at <http://www2.guidestar.org/>.

In addition, the IRS has established penalties to deal with excessive compensation. Under federal law, board members who knowingly approve excessive compensation and benefits for certain officers could also be subject to penalties. For more information, see the IRS charity website at <http://www.irs.gov/charities>.

Best practices in fulfilling your responsibilities for executive selection and compensation include:

- Being involved in the selection and review of the nonprofit's chief executive officer. Make certain that the chief executive officer has the appropriate skills, education and experience to carry out his or her responsibilities.

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- Knowing what the chief executive officer is paid, including fringe benefits. If the board has a formal compensation committee that recommends a specific salary, you are still responsible as a board member for reviewing and approving that salary level and for asking questions about how the salary level was determined. In addition, the IRS asks governing boards to review comparable salary data and specific performance measures to determine appropriate compensation levels.
- Being sensitive to the chief executive's salary in the context of your community. Remember that compensation of the chief executive officer is important to those who donate to the nonprofit, to those who are served by the nonprofit, and to the community at large.

Conflicts of Interest

Board members and officers owe their nonprofit organizations the duty of loyalty, which means acting in the best interests of the nonprofit. Prior to joining a board or being employed as an officer by a nonprofit, you must disclose any personal or business relationship that is in conflict with this duty of undivided loyalty, whether direct or indirect, actual or potential. If a transaction is presented to the board in which you, as an officer or board member, have a direct or indirect personal or business interest, you must disclose that conflict of interest to the board, remove yourself from any board discussion, and not vote on the matter. Board chairs should ask their board members and officers to sign conflict of interest statements at the start of each year in order to document existing or potential conflicts. Officers should disclose to the board any potential conflict of interest that may have arisen in the course of business.

If you are asked to vote on a conflict of interest transaction, you must do so with only the best interests of your nonprofit in mind. Before approving a conflict of interest transaction, take great care to ensure that the transaction is fair to the nonprofit, that it is in the best interest of the organization, and that it furthers the nonprofit's mission. Make sure that your reasons for approving the transaction are well documented in the board's minutes. Also be aware that Tennessee law prohibits certain conflict of interest transactions, such as loans to officers or board members.

Finally, you should know that if you vote to approve a conflict of interest transaction, you may be held personally responsible to the nonprofit if the transaction harms the nonprofit or is otherwise unfair. You also have the right as a board member to sue a conflicted party on behalf of your nonprofit organization if the transaction is unfair or harmful.

Protecting the Assets of Your Nonprofit Organization

Your duties include protecting the assets of your nonprofit organization. Tennessee law requires nonprofit organizations to use their assets to fulfill their charitable purposes and not for the benefit of private parties. You must ensure that your nonprofit is using its resources as directed in its articles of incorporation and bylaws. If your nonprofit organization sells assets to or purchase assets from a for-profit company, it is important that the sale or purchase price be fair to your organization.

In addition, Tennessee law requires notification be provided to the Attorney General of certain extraordinary events, including:

- a merger of your nonprofit organization;
- a sale of substantially all of your nonprofit organization's assets to a for-profit company; or
- the dissolution of your nonprofit organization.

Tennessee law requires that notice be given to the Attorney General of these events at least 20 days prior to the expected close of the extraordinary event. Generally, officers of the nonprofit are responsible for providing the appropriate notice to the Attorney General. The board of directors should take steps to ensure that the officers have complied with the law. If the officers have not provided notice, then the board must take action to provide the required notice.

The Attorney General's Office will then request information from your nonprofit organization about the transaction. Depending on the size of the transaction, the information request may be brief or extensive. Model information requests are available for review on the Attorney General's website but may be tailored to your specific transaction. The Attorney General's Office will assess the information provided to make sure that nonprofit assets are being protected consistent with Tennessee law. In particular, the Attorney General's Office will evaluate the transaction to determine if the nonprofit organization is receiving fair market value for its assets.

In practice, officers and the board should consider taking the following actions before notifying the Attorney General:

- Keep detailed board minutes discussing the transaction. This shows your board is properly fulfilling its fiduciary obligations.

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- Review the Attorney General’s model information requests early in the process. Have the staff of your nonprofit begin gathering responsive documents about the transaction so that you can promptly respond to the information request. Failure to respond to the Attorney General’s information request in a timely fashion may delay your organization’s transaction.
- Seek as many purchasers as possible. While your organization need not automatically sell to the highest bidder, multiple bidders will help show the transaction is fair.
- If you are approached by a single purchaser, look for alternative buyers. If no alternative buyers are available, obtain an independent appraisal of the value of the assets being sold or transferred. The appraisal will be important evidence of the fairness of the transaction.
- Consider contacting the Attorney General’s Office more than 20 days prior to the transaction’s scheduled closing date. Complex transactions may take significantly more time to evaluate, and the Attorney General’s Office can give you an estimate of the time it will take to review. If the Attorney General’s Office does not have enough time to review the transaction before the scheduled closing date, it may seek to delay or block the transaction.

Public Benefit Hospitals

In 2006 the Tennessee General Assembly passed the “Public Benefit Hospital Sales and Conveyance Act,” Tenn. Code Ann. §§ 48-68-201, *et seq.* Under the new act, any nonprofit or community-owned hospital must provide written notice to the Attorney General 45 days before selling or transferring control of its assets. The hospital must also certify that each member of its board has been given a copy of the Public Benefit Hospital Sales and Conveyance Act of 2006.

Once the Attorney General receives notice of a proposed hospital sale or transfer of control, the Office of the Attorney General will request additional information from the parties involved in the transaction. In addition, within five days of receipt of notice by the Office of the Attorney General, the hospital must publish notice of the proposed transaction in at least one local, widely read newspaper.

As with other transactions involving nonprofit organizations, sales of public benefit hospitals must be fair to the nonprofit or governmental organizations involved. You should follow the same principles outlined in the section above entitled “Protecting the Assets of Your Nonprofit Organization” if your organization is contemplating a hospital sale or transfer of control.

Dissolving a Nonprofit Organization

In the course of your service, you may have to make the decision to close a nonprofit organization that, for whatever reason (e.g., lack of funding, fulfillment of purpose, etc.), is no longer able or is no longer needed to continue its charitable mission. It is essential that officers and board members continue to fulfill their fiduciary obligations throughout the entire dissolution process. Dissolution is an extraordinary event that must be reported to the Attorney General. After reporting the event, the Attorney General's Office will send your nonprofit an information request packet. If your dissolution is simple, you may only be required to fill out a brief affidavit. A model information request packet and affidavit are available for your review on the Attorney General's website.

The Attorney General will need to know the value of your nonprofit's assets and what your organization intends to do with those assets upon dissolution. In general, your nonprofit can only donate its assets to other nonprofits, preferably with a similar purpose to your organization, and some assets may be restricted to a specific purpose. Your nonprofit organization's articles of incorporation and bylaws may also contain restrictions concerning asset distribution. You are responsible for ensuring that your organization distributes its remaining assets appropriately.

Your nonprofit organization will also need to file certain documents with the Tennessee Department of State, including Articles of Dissolution. For more information and forms, please visit http://state.tn.us/sos/bus_svc/forms.htm#nonprofit.

The Charitable Solicitations Act and Other Laws

Your nonprofit organization may be subject to other Tennessee laws. For example, if your organization solicits contributions, it may be subject to the Charitable Solicitations Act, Tenn. Code Ann. §§ 48-101-501, *et seq.* The Charitable Solicitations Act requires that charitable organizations who solicit contributions from, or within, the State of Tennessee register with the Department of State's Division of Charitable Solicitations and Gaming, unless exempt. The Act also requires certain professional fundraisers to register with the division and file certain documents with the division prior to soliciting contributions on behalf of a charitable organization. Finally, the Charitable Solicitations Act prohibits false and misleading solicitation practices, and empowers the division to investigate violations of the Act, and impose a civil penalty of up to \$5,000 for each and any violation of the Act.

If the organization is an eligible Internal Revenue Code 501(c)(3) organization, it may conduct a gaming event pursuant to the Tennessee Charitable Gaming Implementation

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Law, Tenn. Code Ann. §§ 3-17-101, *et seq.*, which is administered and enforced by the Division of Charitable Solicitation and Gaming. You should familiarize yourself with state and federal laws relevant to your organization.

Charitable Trusts and Private Foundations

Your nonprofit may be the beneficiary of a charitable trust. Charitable trusts are trusts created for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community. Charitable trusts are subject to the provisions of the Tennessee Uniform Trust Code, Tenn. Code Ann. §§ 35-15-101, *et seq.*, and may also be subject to the provisions of the Charitable Beneficiaries Act of 1997, Tenn. Code Ann. §§ 35-13-101, *et seq.*, the Uniform Prudent Investors Act, Tenn. Code Ann. §§ 35-14-101, *et seq.*, and the Uniform Prudent Management of Institutional Funds Act, Tenn. Code Ann. §§ 35-10-201, *et seq.* Under the Uniform Trust Code, the Attorney General is given the status of a qualified beneficiary. As such, the Attorney General is required to be a party in any judicial or nonjudicial proceeding involving a charitable trust.

Your nonprofit may also be the beneficiary of a charitable gift. A charitable gift is any gift clearly intended for any purpose commonly considered to be charitable or charitable under Tennessee law or the Internal Revenue Code. Charitable gifts may be subject to the Charitable Beneficiaries Act of 1997. Under that Act, the Attorney General is given the statutory duty to represent the interest of charitable beneficiaries, potential charitable beneficiaries and the people of the State of Tennessee in all proceedings involving charitable gifts, and charitable trusts.

The Internal Revenue Service requires private foundations to provide copies of Form 990-PFs to state attorneys general. To determine whether your foundation must send a copy of its 990-PF to the Tennessee Attorney General's Office, consult the IRS website at <http://www.irs.gov>. Mail copies of the forms to the following address: Tennessee Attorney General, Attn: Library, P. O. Box 20207, Nashville, TN 37202-0207.

The Office of the Attorney General

The Tennessee Attorney General has broad oversight and authority over Tennessee nonprofit organizations. If you have questions concerning the Attorney General's oversight of nonprofits under the Tennessee Nonprofit Corporation Act, please contact the Public Interest Division at (615) 532-7917. Please note that the Attorney General cannot provide legal advice to you or your nonprofit. If your organization requires specific legal advice, the Tennessee Bar Association offers information about obtaining an attorney on their website at http://www.tba.org/LawBytes/T1_1000.html.

The Tennessee Department of State

The Tennessee Department of State is responsible for processing documents filed pursuant to the Tennessee Nonprofit Corporation Act. Additionally, the Secretary of State is responsible for administering and enforcing the Tennessee Charitable Solicitations Act and the Tennessee Charitable Gaming Implementation Law. If you have questions regarding filing documents under the Tennessee Nonprofit Corporation Act, please contact the Division of Business Services at business.services@tn.gov or 615-741-2286. If you have questions regarding the Tennessee Charitable Solicitations Act and the Tennessee Charitable Gaming Implementation Law, please contact the Division of Charitable Solicitations and Gaming at charitable.solicitations@tn.gov or 615-741-2555.

Resources

The following resources are included for your information. The inclusion of outside sources does not, in any way, imply endorsement by the Attorney General, Secretary of State, or the Center for Nonprofit Management.

- **Tennessee Attorney General's Office:** <http://www.tn.gov/attorneygeneral/>

The Attorney General's website includes Tennessee statutes relevant to nonprofit organizations, model information requests, and information concerning the Attorney General's oversight of nonprofits. It also includes this Guidebook in pdf format.

- **Tennessee Department of State:** <http://www.tennessee.gov/sos>

The Tennessee Department of State's Division of Business Services is responsible for processing documents filed pursuant to the Tennessee Nonprofit Corporation Act. In addition, the Department of State's Division of Charitable Solicitations and Gaming administers and enforces the Tennessee Charitable Solicitations Act and the Tennessee Charitable Gaming Implementation Law. Information, forms, statutes and electronic filing are available at the Department of State's website.

- **The Center for Nonprofits (Chattanooga):** <http://www.cnpchatt.org>
- **The Center for Nonprofit Management (Nashville):** <http://www.cnm.org>
- **The Alliance for Nonprofit Excellence (Memphis):** <http://www.npexcellence.org>

These nonprofits offer a variety of services and guidance to nonprofit organizations in East Tennessee, Middle Tennessee, and West Tennessee respectively, including workshops, training, and networking with other Tennessee nonprofit organizations.

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- **IRS Tax Information for Charities & Other Non-Profits:** <http://www.irs.gov/charities/index.html>

The Internal Revenue Service's Tax Information for Charities and Other Non-Profits webpage offers information to charitable organizations seeking 501(c)(3) status. The site includes information on the lifecycle of nonprofit organizations, tax guidance, and instructions and training for the new Form 990.

- **National Association of State Charity Officials:** <http://www.nasconet.org>

The National Association of State Charity Officials (NASCO) is an association of state officials tasked with regulating nonprofit and charitable organizations in the U. S. The NASCO website offers general information about starting a nonprofit organization, board governance and news relevant to government regulation of charities.

- **Guidestar:** <http://www2.guidestar.org>

Do you know whether you are making a contribution to a legitimate nonprofit organization? The answer will affect whether or not your donation is tax deductible. Guidestar offers free research into the purposes, agendas and finances of nonprofit organizations.

Acknowledgment

We would like to thank the Office of the New Hampshire Attorney General, and in particular, Michael DeLucia, Sr., Assistant Attorney General and Director of the Charitable Trust Unit, whose knowledge and experience were a valuable resource in the preparation of this Guide. The "Guidebook for New Hampshire Charitable Nonprofit Organizations," prepared by Mr. DeLucia and his colleagues served as the model for this Guidebook.



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