Strengthen Leadership Accountability & Fiduciary Duty

Board Governance Excellence

Strategic Framework for Effective Church Board Leadership

Church Clergy Tax Management & Compliance

Today's Agenda

- Understanding Board Fiduciary Duties: The Three Pillars
- Duty of Care: What Board Members Must Do
- Duty of Loyalty: Conflicts & Self-Dealing Prevention
- Duty of Obedience: Legal Compliance Framework
- Personal Liability: How to Protect Yourself
- Board Training & Implementation Roadmap

Board Member Personal Liability Exposure

- Board members can be sued individually for governance failures
- Personal liability is NOT automatically covered by church liability insurance
- Directors & Officers (D&O) liability insurance is ESSENTIAL protection
- Breach of fiduciary duty lawsuits increasingly filed against nonprofit boards
- Church members/donors filing suits: "where did my money go?"
- Board members face personal judgment liens on homes and assets
- Statutory protections vary by state - know YOUR state's laws

The Three Fiduciary Duties: Foundation of Board Leadership

Duty of Care

Attend meetings, review information, make informed decisions in good faith

Duty of Loyalty

Disclose conflicts, prioritize church interests, avoid self-dealing

Duty of Obedience

Ensure compliance with bylaws, state law, and IRS regulations

Duty of Care: Core Requirements

- **Attend Meetings:** Regular board meetings (monthly or quarterly minimum)
- **Be Prepared:** Review materials BEFORE meeting, ask informed questions
- **Participate Actively:** Don't just rubber-stamp decisions - challenge, discuss, deliberate
- **Request Information:** Demand financial statements, audit reports, legal opinions
- **Make Informed Decisions:** Base decisions on facts, not assumptions
- **Document Everything:** Ensure meeting minutes capture discussions and votes

Duty of Care - Common Violations

❌ Violations Include:

- Missing board meetings
- Not reviewing financial statements
- Approving compensation without analysis
- No audit or review engagement

✅ How to Comply:

- Attend 75%+ of meetings
- Review monthly financials
- Ask questions on major decisions
- Request audit annually

Duty of Loyalty: Self-Dealing is the Largest Breach

- **Self-Dealing Definition:** Board member approving transaction from which they benefit
- **Examples:** Pastor's family company gets contract, board member's relative hired, favorable loan terms
- **Liability Risk:** Board member personally liable for damages + must restore benefits to church
- **IRS & AG View:** Self-dealing = theft from charitable assets (criminal exposure)
- **Prevention:** Disclose ALL conflicts, recuse from voting, get competitive bids
- **Documentation:** Board minutes must document disclosure and recusal

Conflict of Interest Policy: Non-Negotiable

- **Required Elements:** Written policy adopted by board, reviewed annually
- **Annual Certification:** All board members sign conflict disclosure form every year
- **Disclosure Triggers:** Any financial interest in contracts, vendors, hirings, purchases
- **Immediate Recusal:** Conflicted person leaves room during discussion and voting
- **Competitive Process:** For related-party contracts, must get bids from unrelated vendors
- **Board Approval:** Even after recusal, board must approve as "fair to organization"

Duty of Obedience: Legal & Regulatory Compliance

- **Bylaw Enforcement:** Ensure church operates according to its own bylaws
- **State Law Compliance:** Follow nonprofit incorporation statute requirements
- **IRS Compliance:** Maintain 501(c)(3) status through proper tax filing & reporting
- **Attorney General Compliance:** Follow state charity registration & governance requirements
- **Employment Laws:** Comply with payroll tax, anti-discrimination, wage & hour laws
- **Document Preservation:** Keep all records 7 years minimum (IRS requirement)

Board Meetings: The Foundation of Governance

Meeting Frequency

- Monthly meetings preferred
- Quarterly minimum
- Annual at least (not sufficient)
- Special meetings as needed

Documentation Required

- Date, time, location
- Members present/absent
- Topics discussed
- Decisions made & votes

Board Minutes: Detailed Documentation Standards

- **Compensation Decisions:** Document amounts approved, job duties, FMV analysis referenced
- **Conflict Disclosures:** "John disclosed interest in XYZ vendor. John recused. Board voted 4-0 to approve."
- **Financial Approvals:** "Board reviewed monthly statements. No variances. Approved."
- **Major Purchases:** Amount approved, vendor, purpose, any competitive bidding process
- **Audit Findings:** Document receipt of audit report, discussion of findings, remediation plans
- **Policy Adoptions:** Record formal board action adopting or amending policies

Directors & Officers (D&O) Liability Insurance: CRITICAL

- **What It Covers:** Defense costs & settlement for claims against individual board members
- **Essential Protection:** Individual is sued personally for governance failure - D&O pays legal defense
- **Cost:** Typically $1,500-5,000 annually for small/mid-size churches (reasonable)
- **CRITICAL:** Church general liability does NOT cover individual board member claims
- **Specialized Carrier:** Church Mutual, GuideOne, Hartford Covenant Church programs
- **Non-Negotiable:** Every board member should insist on D&O coverage - it protects them personally

D&O Coverage: Important Limits & Exclusions

✅ D&O COVERS:

- Governance failure claims
- Breach of duty lawsuits
- Defense costs
- Settlement/judgment

❌ D&O EXCLUDES:

- Criminal conduct
- Fraud/embezzlement
- Deliberate misconduct
- Uninsured member claims

Case Study: The Board Member Personal Liability Nightmare

Situation: Church board member sued personally for approving $100K contract to pastor's company without competitive bidding. Church had no D&O insurance.

The Lawsuit: Donor filed suit claiming breach of fiduciary duty. Legal defense cost $80K. Settlement $50K. Board member personally liable for everything - church couldn't reimburse under bylaws.

Result: Board member's home went into judgment lien. Personal financial ruin. Years to recover.

✅ **Prevention:** D&O insurance ($2K/year) + competitive bidding + board approval process.

Case Study: The Absentee Board Member Liability

Situation: Board member attended 2 of 12 meetings per year, never reviewed financials, rubber-stamped all decisions.

The Problem: Treasurer embezzled $200K over 3 years. Board member claimed he didn't know - insufficient due diligence.

Result: Donor lawsuit against board for breach of Duty of Care. D&O insurance covered defense but premiums increased 300%.

✅ **Prevention:** Monthly board meetings, monthly financial statements, quarterly audit reviews.

Board Governance Excellence Checklist

- ☐ Minimum 3 unrelated board members (more independent = better)
- ☐ Monthly or quarterly documented board meetings with minutes
- ☐ Board chair separate from pastor (reduces conflicts)
- ☐ Conflict of interest policy signed annually by all members
- ☐ D&O liability insurance coverage in effect ($1M minimum)
- ☐ General liability insurance naming church and board
- ☐ Written bylaws governing board structure and authority
- ☐ Board committee structure (Finance, Audit, Compensation committees)

Board Governance Checklist - Continued

- ☐ Monthly financial statements reviewed by board
- ☐ Annual independent audit or review engagement completed
- ☐ Board approval process for major purchases/contracts documented
- ☐ Compensation approved in writing with FMV analysis
- ☐ Board members attend 75%+ of meetings (fiduciary expectation)
- ☐ Whistleblower policy adopted for reporting concerns
- ☐ Document retention policy in place (7 years minimum)
- ☐ Annual board self-evaluation and training conducted

Board Member Training: Essential for Success

- **Initial Onboarding:** New member orientation on bylaws, fiduciary duties, current policies
- **Annual Training:** All board members attend governance training (1-2 hours minimum)
- **Topics:** Fiduciary duties, conflict of interest, financial oversight, audit process
- **Documentation:** Keep records of training attendance (IRS/AG verification)
- **External Resources:** Church Law & Tax, National Council of Nonprofits, board governance consultants
- **Self-Evaluation:** Annual board self-assessment identifying strengths and gaps

Committee Structure: Delegating Oversight

- **Finance Committee:** Monthly budget review, variance analysis, approval authority
- **Audit Committee:** Annual audit planning, findings review, control testing
- **Compensation Committee:** FMV analysis, board compensation approval, housing allowance review
- **Nominating Committee:** Board member recruitment, conflict screening, term limits
- **Committee Charters:** Written charter defining responsibilities, authority, meeting frequency
- **Committee Minutes:** Document all committee decisions and recommendations to full board

Board Governance: 90-Day Implementation Plan

Days 1-30

- Assess current governance
- Review bylaws & policies
- Obtain D&O insurance quotes

Days 31-60

- Draft governance policies
- Secure D&O insurance
- Board orientation meeting

Days 61-90

- Board adoption of policies
- Committee establishment
- Annual training session

CRITICAL: You Cannot Waive Fiduciary Duties

- **Cannot Be Waived:** Fiduciary duties cannot be eliminated by board resolution or bylaws
- **Cannot Be Modified:** You cannot reduce standard of care below "reasonably prudent person" standard
- **Liability is Personal:** Even if church reimburses, if reimburse is breached, you're still liable
- **D&O Insurance Essential:** Only protection is D&O insurance covering defense & settlement
- **Statute of Limitations:** Breach claims can be filed for 3-7 years (state specific)
- **Bottom Line:** Accept the duty or don't serve on the board - no middle ground

Red Flags That Invite Liability Lawsuits

- ☐ No board meetings or meetings only annually
- ☐ No written minutes documenting decisions
- ☐ No conflict of interest policy
- ☐ Compensation approved without FMV analysis or board approval
- ☐ Major purchases without competitive bidding
- ☐ No annual audit or review engagement
- ☐ Pastor or board member family members hired without competitive process
- ☐ No D&O insurance coverage

Key Takeaways

- Three fiduciary duties (care, loyalty, obedience) are legally required - you cannot opt out
- Board members face PERSONAL liability - not automatic church insurance coverage
- D&O insurance is non-negotiable protection (board should insist on it)
- Documentation (minutes, resolutions, analyses) is your defense against liability claims
- Monthly board meetings + regular audit = fiduciary excellence
- Conflicts must be disclosed and member must recuse - cannot participate in self-dealing

Implement fiduciary excellence - protect yourself and your church's future

Board Governance Starts Today

Next: Financial Transparency & Reporting Standards

Leading with Excellence, Integrity, and Accountability in Church Governance

Thank You

Questions & Discussion Welcome