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Director and Executive Officer Roles in a Nonprofit and Tax Exempt Organizations

Behavioral Health Services Association of SC

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Nonprofit Leadership

“No man will make a great leader who wants to do it all himself or get all the credit for doing it.”

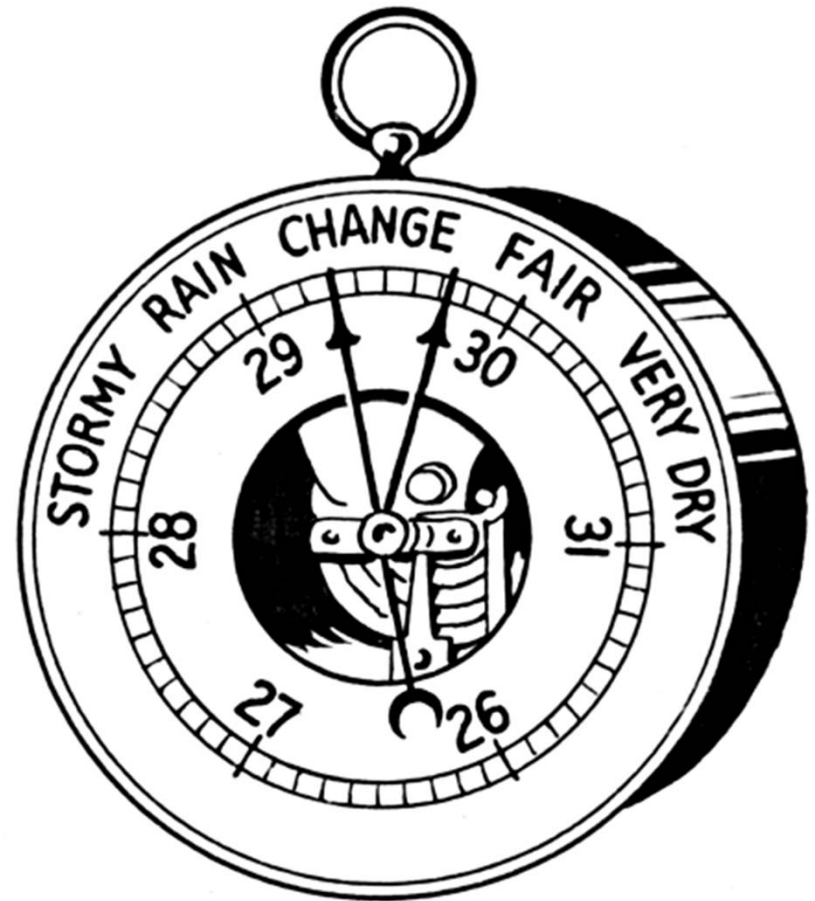
Andrew Carnegie

Nonprofit Boards and their CEOs

THE FUNDAMENTAL RELATIONSHIP

- Foundation
- Lynchpin
- Spear Tip
 - Strategy operations

meets



Nonprofit Leadership – Division of Responsibilities

- **Board**

- Strategic vision
- Budget
- Policy
- Oversight

- **CEO**

- Executes vision
- Day to day operations
- Management of Programs
- Manages employees

Nonprofit Leadership

Relationship Dynamics:

- Fiduciaries
- Employer/ employee
- Contract
- Statute/ Public Policy

Nonprofit Leadership - Fiduciaries



I know we're supposed to be totally loyal, but to whom?

Board – Fiduciary Obligations

- For SC Nonprofit Corporations, except under certain circumstances, “all corporate powers must be exercised by or under the authority of and the affairs of the corporation managed under the direction of its board.” SC Code section 33-31-801(b).
- For organizations created by statute or legislation, authority conveyed directly from state gov. to board; scope of authority provided by statute.

Director Duties

- **S.C. Code Ann. §33-31-830(a)** sets forth the general standards of conduct for directors of nonprofits, and requires directors to act:
 - 1) in good faith;
 - 2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
 - 3) in a manner the director reasonably believes to be in the best interest of the corporation

Nonprofit Leadership - Fiduciaries

Farcus

by David Waisglass
Gordon Coulthart



**“What conflict of interest?!
I work here in my spare time.”**

Director Duties

- S.C. Code Ann. §33-31-831(a), Conflicts of Interest:
“A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect interest. “
- SC Ethics Act – Section 8-13-700
 - May not use office to obtain economic gain for himself, family member, or business colleague.
- IRS Conflict of Interest Policy:
<https://www.irs.gov/instructions/i1023/ar03.html>

Federal “Duties”

Associated with Tax Exemption

- Internal Revenue Code (IRC) Section 501(c)(3) really provides a description of what is a tax exempt organization:

“Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition ... or for the prevention of cruelty to children or animals...”

- *Charitable Purpose* is the leading component.

Prohibition Against Private Inurement

- IRC Section 501(c)(3) additionally provides:

no part of the net earnings of which inures to the benefit of any private shareholder or individual

- Must put organization before self.
- Observe conflict of interest policy and rules at all times.

CEO and other Officers

- Federal “*duties*” apply to all officers.
- S.C. Code Ann. § 33-31-842 sets forth the general standards of conduct for officers with **discretionary** authority
 - Held accountable at same **Fiduciary** standard as the Board.
- Critical to **understand and document** the grant and scope of discretionary authority provided to CEO.

CEO – Sources of Authority

- Under state law, the Board causes authority to be granted to CEO.
 - See S.C. Code Ann. §33-31-841
- Scope of such Authority is defined within:
 - Bylaws
 - Expenditure Controls
 - Policies
 - Employee Handbook

Traditional Role of CEO

- The CEO/Executive Director runs the day-to-day management activities of the nonprofit, which can include:
 - Reports to the Board of Directors
 - Manages employees
 - Implements Policies and Programs of Nonprofit and directives of Board.
- Maintenance of the boundary between Board and CEO is critical for the health of a Nonprofit

Employment Arrangement

- Board as Employer – CEO as Employee
- Professional Employer Organizations
- Employment Agreement
 - Defines duties and role of CEO
 - Defines termination and severance

CEO Compensation

- Compensation discussion illustrates a potential conflict between a Board and its CEO
- Implicates private inurement – both at the time of the hiring and perhaps more influentially at contract renewal points or during future compensation negotiation.
- CEO as an influential insider of the Nonprofit.

CEO/Executive Director Compensation

- CEO compensation must not exceed what is “*fair and reasonable.*”
 - The IRS strictly enforces and prohibits “*private inurement.*”
 - Excessive compensation paid to nonprofit executives is the most common violation of this prohibition.
 - IRS *penalties* for excess compensation range from fines to revocation of the organization’s tax-exempt status.



CEO Compensation

Excess Benefit Transactions

- Introduced in 1996 pursuant to IRC §4958 as a form of “***Intermediate Sanctions.***”
- An “**excess benefit transaction**” is a common type of private inurement, and occurs when an insider, technically referred to as a “***disqualified person***” receives an unreasonable benefit pursuant to a transaction with the organization.
- This is the 501(c)(3) equivalent of insider trading.

CEO Compensation

Excess Benefit Transactions

- A ***disqualified person*** includes:
 - any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization
 - a member of the family of an individual described above
 - a 35-percent controlled entity
- A disqualified person is also anyone that has **substantial influence** over the nonprofit, like a director or officer, including the CEO.

CEO Compensation

Excess Benefit Transactions

- Intermediate Sanctions take the form of Excise Taxes:
 - **First Tier Tax:** a 25% tax on the excess benefit payable by the disqualified person
 - **Second Tier Tax:** if not paid, an additional tax of 200% of the excess benefit is imposed on the disqualified person
 - A tax of 10% is ALSO imposed on the organization managers (i.e. Board members, officers) who knowingly approved the transaction

CEO Compensation

Excess Benefit Transactions

- Standard of “*Reasonableness*”
- Compensation is reasonable if the value of services equals the amount that would be paid ordinarily for like services by like enterprises, whether taxable or tax-exempt, under like circumstances. Treas. Reg § 53.4958-4(b)(1)(ii)(A).
- Based on all the relevant facts and circumstances. Treas. Reg. § 53.4958-4(b)

CEO Compensation

Excess Benefit Transactions

- Rebuttable Presumption of Reasonableness
- Requirements:
 - Recusal of persons with Conflict of Interest
 - Board must rely on appropriate comparability data prior to making significant decisions; and
 - Properly document each decision at the time made and include the basis for the decision.
 - Example: Private Letter Ruling 200244028
 - Must meet all three requirements to establish the rebuttable presumption of reasonableness.
 - Here there was no consideration of comparability data, therefore the organization did not establish the rebuttable presumption.

Hiring Decisions

- A current director wants to be CEO...
 - What problems does this present?
- The Board wants to hire her anyway... what should we do?
 - Resignation
 - Manage conflicts... disqualified person status will remain
 - Rebuttable presumption of reasonableness

CEO Performance Evaluation

Clarise's First Day

by \$Bill



PIXTON

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CEO Performance Evaluation

- Board should ensure CEO:
 - Understands the role of CEO in relation to the stated objectives of the Board
 - Is educated about how to work with and communicate with the Board
 - Understands how he or she will be held accountable and evaluated

CEO Performance Evaluation

- **Annual Performance Metrics**
 - establish at beginning of the year.
 - Agree upon measures and a defined process to evaluate CEO
- Accept **input from CEO** for performance metrics, but understand limitations and roles.

CEO Performance Evaluation

- Who will evaluate CEO – make this known to CEO early in year;
- Self-evaluation by CEO at conclusion of year;
- Presentation of report to CEO;
 - Provide corrective guidance upon finding of deficiency
- Board and CEO signs off on review.

Examining the Board - CEO Relationship



Examining the Board - CEO Relationship

- Relationship between CEO and Chair.
 - Collaboration, trust, respect, mutual support.
- Communicate - Lunch or coffee between CEO and individual directors goes a long way.
- Board meetings are a critical a moment to evaluate leadership, organization, and operations.
 - Chair and CEO to develop jointly.

**THE TOP 10 SIGNS
OF A
DYSFUNCTIONAL CEO / BOARD CHAIR
RELATIONSHIP**

-Joan Garry

- (1) Board Chair didn't want the job in the first place. Was the only person who didn't step back when the ask was made.
- (2) CEO doesn't tell the Board Chair anything meaningful. Keeps her at arm's length. Hopes they don't interact a lot. Perceives interaction as "intrusion."
- (3) Board Chair intrudes. Sees the role as good old standard boss/employee relationship and attempts to micro-manage the activities of the CEO.
- (4) Board Chair actually wants the CEO job.

- (5) Board Chair comes in distrusting / disrespecting the CEO and uses the platform to make the case that it is time to boot him.
- (6) CEO believes that the Board Chair's primarily role is to 'protect' her from the big bad Board.
- (7) Board Chair sees her role as providing cover for CEO and to 'save' her from the annoying board with their nutty ideas.

(8) Board Chair is not accessible to the CEO when she needs him.

(9) There is no regular communication in either direction.

(10) Board chair delegates board and executive committee meeting agendas and actual running of the meeting to the CEO

Nurturing the Bond between a Board and its CEO

- Encourage Board involvement as volunteer or fundraiser.
- Guard against Director overstepping line into CEO role.
- Empower CEO as sole manager of the employees he or she hires.
 - Employees that run around CEO to Board
- Engage staff to support appropriately the Board and its committees

Nurturing the Bond between a Board and its CEO

- Strategic Planning and Regular Budgeting.
 - Engage CEO as a critical voice in any such discussions.
- Search and nomination of new directors
 - CEO will have an opinion on needs of Nonprofit
- Board sees the professional development of CEO as investment in the organization.

Nurturing the Bond between a Board and its CEO

- Communication is key
 - Document scope of authority of CEO.
 - Performance reviews and constructive feedback.
- Make regular times for CEO and Chair to meet
- Despite conflict, take a breath and remember the mission!

Nonprofit Leadership

“There are many leaders, not just one. Leadership is distributed. It resides not solely in the individual at the top, but in every person at every level who, in one way or another, acts as a leader to a group of followers - wherever in the organization that person is, whether shop steward, team head, or CEO.”

Daniel Goleman, Richard Boyatzis and Annie McKee
Primal Leadership: Realizing the Power of Emotional Intelligence.

THANK YOU!

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