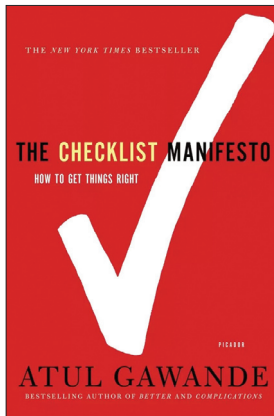


TOOL #7: The Board's Annual Legal Audit

Use this TRUE OR FALSE annual audit as a first step in assessing your ministry's compliance with applicable local, state, and federal laws and regulations.



Atul Gawande, the author of *The Checklist Manifesto*, interviewed the managing partner of a California investment firm who is a checklist zealot. He cited the “cocaine brain” that researchers often experience when investigating company financial reports. Without a thorough checklist (honed over years of experience), a greed mode kicks in for investors and wipes out thoughtful discernment.

Another firm uses a “Day Three Checklist” (what to ask on the third day of analysis).

“Forty-nine times out of fifty, he said, there’s nothing to be found. ‘But then there is.’”¹

What Could Possibly Go Wrong?

Where’s the Checklist?

Imagine this scenario. It’s Saturday 7:30 a.m. in the boardroom. You have hot coffee with your favorite creamer. Your “board buddy” (a person assigned to all new board members) has guided you through two informative orientation sessions. You’ve reviewed the ministry’s rolling three-year strategic planning process—and learned how it was birthed by prayer and spiritual discernment. You’ve read the Board Policies Manual, and you’ve signed the Board Member Annual Affirmation Statement, the Confidentiality Policy, and the Conflicts of Interest Policy.

It gets better! This Christ-centered board is forward-looking, yet humble, and board member micromanaging is gently prohibited. The board has welcomed you and the new class of board members with warmth and affirmation. You’re ready to deploy your spiritual gifts, your top-five strengths from the CliftonStrengths® assessment, and the board chair knows your social style—you’re an “analytical” (one of four styles).

What could possibly go wrong?

The board chair begins. “Thank you, everyone, for attending this early morning special meeting of the board. We have just one agenda item: a bookkeeper in our accounting department has been accused of diverting payroll taxes to his own checking account. We have no funds to cover the delinquent taxes and penalties.”

Yikes! This is new territory for you. The room goes quiet. “Lord, help us...” you plead silently to the heavens. Then your beating heart calms as you realize...surely, there must be a best practice checklist for this kind of crisis. Surely there is a policy and a step-by-step procedure. Airline pilots have emergency checklists. Surgeons have checklists.

Hmmm. Maybe a checklist would have prevented this?²

¹ Atul Gawande, *The Checklist Manifesto: How to Get Things Right* (New York: Metropolitan, 2009), 166–67.

² Adapted from Dan Busby and John Pearson, *Lessons From the Church Boardroom: 40 Insights for Exceptional Governance*, 2d ed. (Winchester, VA: ECFAPress, 2019), 17–18.

The Board's Annual Legal Audit



17 Statements the Board Must Address Annually

Your board should expect clarity and honesty from the CEO, the COO, the CFO, staff, and all of the board's committees. To provide clarity—so board members understand basic legal issues and legal trends—the information should be presented with a variety of approaches (for the diverse learning styles of your board members) and can include verbal and written reports, dashboards, and graphs. But there's another important step—an annual checklist.

TRUE OR FALSE? Here are 17 statements that can be adapted for your ministry. Ask your CFO and COO to provide the answers for the question, “How does the board know?” Ultimately, of course, for the board to have faith and trust in the accuracy and veracity of the answers to these statements—the board will be dependent on the honesty and integrity of the CEO and the staff.

Adapt these statements for your ministry—and review the answers at least annually.

See pages 70–71 for a sample completed legal audit.

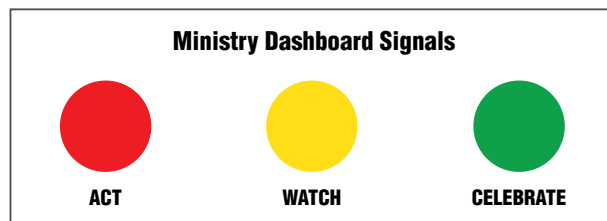
| The Board's Annual Legal Audit | True/ False | How does the board know? |
|--|----------------|--------------------------|
| 1. The board has reviewed organizational practices within the past year to ensure compliance with its corporate documents (Articles, Bylaws, etc.) and applicable state and federal law. | | |
| 2. Appropriately experienced legal counsel has reviewed the articles of incorporation, bylaws, and board policies in the last three years. | | |
| 3. Our annual filings with each applicable state are current to maintain our corporate status. | | |
| 4. Our annual filings with each applicable state are current for charitable registration purposes. | | |
| 5. We are in compliance with our loan covenants, if applicable. | | |
| 6. All payroll tax filings are current with federal, state, and local governments. If so, what is the basis for that determination? | | |

| The Board's Annual Legal Audit | True/ False | How does the board know? |
|--|----------------|--------------------------|
| 7. All informational filings with the federal government (Forms 1098, 1099, 5578, and others, as applicable) are current. | | |
| 8. The annual filings of Form 990 and 990-T, if applicable, are current. | | |
| 9. The ministry is in compliance with all significant contractual agreements. | | |
| 10. All filings for the ministry's copyrights and trademarks are current. | | |
| 11. The ministry's insurance coverages are adequate and all insurance policies are in force. | | |
| 12. The ministry uses written memos of understanding or contracts to specify the roles and responsibilities of the parties to any partnership, joint venture, or other collaboration, signed by all parties to the agreements. | | |
| 13. All ministry funds are being expended consistent with the organization's mission and for tax-exempt purposes (for ministry purposes, not private benefit). | | |
| 14. The board has approved the establishment of each type of restricted fund. | | |
| 15. Giver-restricted funds are being disbursed in a timely manner. | | |
| 16. Giver-restricted funds are always used for the intended purpose. | | |
| 17. We have not borrowed any of the restricted asset balances to fund operational expenses in the last year. | | |

Sample completed Board's Annual Legal Audit³

| The Board's Annual Legal Audit | True/ False | How does the board know? |
|--|----------------|---|
| 1. The board has reviewed organizational practices within the past year to ensure compliance with its corporate documents (Articles, Bylaws, etc.) and applicable state and federal law. | F | We are three years past due on completing this review. |
| 2. Appropriately experienced legal counsel has reviewed the articles of incorporation, bylaws, and board policies in the last three years. | T | Tax counsel completed the most recent review in October of this year. Recommendations were presented to the Governance Committee. The committee will report on these recommendations at the next board meeting. |
| 3. Our annual filings with each applicable state are current to maintain our corporate status. | T | The CFO has verified that all state filings are up-to-date for the current year. |
| 4. Our annual filings with each applicable state are current for charitable registration purposes. | T | The VP of Development has verified that all state charitable solicitations have been filed for the current year. |
| 5. We are in compliance with our loan covenants, if applicable. | F | On September 30, the ministry was \$100,000 below the cash reserves threshold required by the mortgage loan covenants. |
| 6. All payroll tax filings are current with federal, state, and local governments. If so, what is the basis for that determination? | T | The CFO verified that all tax filings and related payments are current as of September 30. |
| 7. All informational filings with the federal government (Forms 1098, 1099, 5578, and others, as applicable) are current. | T | The CFO verified that all informational filings are current as of September 30. |
| 8. The annual filings of Form 990 and 990-T, if applicable, are current. | T | The Forms 990 and 990-T were filed on May 15. |
| 9. The ministry is in compliance with all significant contractual agreements. | F | External legal counsel has not reviewed all the ministry's significant contractual agreements. |

| The Board's Annual Legal Audit | True/False | How does the board know? |
|--|------------|--|
| 10. All filings for the ministry's copyrights and trademarks are current. | T | External legal counsel has reviewed the status of all copyrights and trademarks and has verified that all filings are current as of August 31. |
| 11. The ministry's insurance coverages are adequate and all insurance policies are in force. | T | The CFO verified this is true as of September 30. |
| 12. The ministry uses written memos of understanding or contracts to specify the roles and responsibilities of the parties to any partnership, joint venture, or other collaboration, signed by all parties to the agreements. | T | The CFO verified this is true as of September 30. |
| 13. All ministry funds are being expended consistent with the organization's mission and for tax-exempt purposes (for ministry purposes, not private benefit). | T | The CFO verified this is true as of September 30. |
| 14. The board has approved the establishment of each type of restricted fund. | F | The board has not been approving the establishment of all types of restricted funds. |
| 15. Giver-restricted funds are being disbursed in a timely manner. | T | The CFO verified this is true as of September 30. |
| 16. Giver-restricted funds are always used for the intended purpose. | T | The CFO verified this is true as of September 30. |
| 17. We have not borrowed any of the restricted asset balances to fund operational expenses in the last year. | F | The CFO confirms that \$200,000 of cash that relates to restricted net assets has been used for operating purposes as of September 30. |



³ Read more on dashboards in Lesson 5 – “Dashboards Are Not a Secret Sauce for Sound Governance” from *More Lessons From the Nonprofit Boardroom: Effectiveness, Excellence, Elephants!* by Dan Busby and John Pearson (Winchester, VA: ECFAPress, 2019), 28–34.