Legal Guide for Arkansas Nonprofit and Volunteer Organizations

By
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Williams & Anderson PLC

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Governor

From the days of the earliest settlers in the territory that was to become the State of Arkansas, neighbors have helped neighbors during good times and bad. Again and again, people banded together to raise barns, fight wildfires, and harvest crops.

In modern times, this same spirit is seen in volunteer service so evident across Arkansas. Adults tutor and mentor children in schools and after-school programs; police, volunteer firefighters, medical personnel, emergency coordinators, and members of faith-based groups respond when disaster strikes. Volunteers help to keep our highways free of litter, make our neighborhoods safer, mentor children from disadvantaged backgrounds, feed the hungry, and comfort the dying. Volunteers, who work through faith-based organizations, state or local agencies, private or nonprofit foundations, make life better for all of us.

I am proud to introduce this new publication, “Legal Guide for Arkansas Nonprofit and Volunteer Organizations”, a resource and guide for nonprofit and volunteer management organizations. It is the result of a collaborative effort between the UALR Bowen School of Law, the Department of Human Services Division of Volunteerism, the Arkansas Service Commission, and Williams & Anderson PLC. Together, their efforts are a model for public-private partnerships. I am confident that this manual will become an indispensable tool for nonprofit and volunteer organizations as they work to improve the quality of life for all Arkansans.

Sincerely,

[Signature]

Mike Beebe

MB:jb
Introduction

Glance at the news, whether you prefer to read it electronically or in print, and you soon realize that we are once again becoming a nation of service-minded individuals. Arkansans are ahead of this curve and in a position to demonstrate leadership in this era of renewed interest in service and in the non-profit sector. This book was written as a guide to help those individuals achieve their goals and see their projects come to fruition.

As Dean of the Bowen School of Law and as an inaugural faculty member of the University of Arkansas Clinton School for Public Service, I have a unique perspective on how people become interested in public service and volunteerism. Law degrees are often associated with high-powered individuals working in tall buildings and commanding large salaries. While some do use their education to pursue that type of career, many more end up pursuing service related careers, especially in the non-profit sector. The mission statement of the Bowen School of Law states that one of our five main objectives is “To serve public interest through a wide range of public service activities for the State of Arkansas…” By exposing our students to volunteerism during law school, Bowen Law School is fulfilling its mission and is itself providing a service to the community.

The “service connection” with the UA Clinton School for Public Service is much more apparent (the name of the school gives it away). The concurrent JD/MPS degree, a one-of-a-kind program, produces individuals who not only use their education to serve local communities but also the global community. Think of it – these students who have a connection to Arkansas are affecting change through service worldwide. That is exciting stuff.

I hope this guide is used often; by those whom I have had the privilege to teach and by those I’ll never meet. I hope all of you experience the joy of seeing your ideas come to life, the reward of seeing your projects help those in need, and the satisfaction of serving instead of being served.

John M. A. DiPippa
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CHAPTER I

The Birth of a Nonprofit

Big News in Little Dipper

Obesity and poor nutrition are major problems among children in communities across America. Claire Morgan’s hometown of Little Dipper, Arkansas, is no exception. In fact, the Arkansas Department of Education had just published a study listing the children of Little Dipper Elementary School as among the heaviest in the state.

The report was front-page news in the Little Dipper Gazette and caused a tremendous stir among Little Dipperans. Mayor Janet Hightower called an emergency town-hall meeting. Because Claire is Mayor Hightower’s personal trainer and a local physical fitness guru, the Mayor asked her to attend. Everyone at the meeting agreed that a comprehensive community initiative was needed. They even came up with a clever name for the program: K-Child, which stands for “Keeping Children Healthy In Little Dipper.”

It seemed like the whole town had promised its support. Local car dealer “Big Bill” Robbins was so inspired that he immediately wrote a check for $10,000 and pledged his fleet of minivans to the program. Reverend Marcus Bailey said the program could use a spare office in his church’s gymnasium. Principal Cynthia Roosevelt promised her cooperation and support in working with the children at the elementary school. Several people signed a mailing list to volunteer their skills and time to the effort. Claire volunteered to organize the entire initiative.
When she got home from the meeting, Claire was excited about all of the good things she planned to do to help the children of Little Dipper lead healthier, more active lives. At the same time, she began to wonder if she had taken on too much responsibility. Questions and doubts started to fill her mind: Did she need to have a meeting? Who was responsible for making sure everything worked out? What was she going to do with the check for $10,000? What if someone got hurt at an activity? Did she need insurance?

Introduction

Most of us have been like Claire at some point in our lives, facing a new challenge and not sure what to do next. This can be especially true when the law is involved—even a lawyer may need some time to figure out one’s rights, or the legal implications of one’s actions and decisions. The purpose of this book is to explain many of the legal issues that commonly face individuals in the field of volunteer program management. Recognizing that most of this book’s readers will not have formal legal training, the authors seek to describe legal issues from the point of view of volunteer managers, in terms of situations they commonly face.

Each chapter of this book begins by describing a situation confronting the fictional Claire Morgan and her organization, K-Child, in the imaginary town of Little Dipper, Arkansas. From there, the authors discuss the legal issues that Claire may face,
and what steps she can take to ensure that the interests of her organization, K-Child, are achieved. It is our hope that, after reading this book, volunteer managers will be more comfortable with relevant legal issues and will have a better idea of when it is time to contact an attorney.

Returning to Claire, it seems like she is off to a great start. She has an office, volunteers, money, and community support. So, why is she still worried? It turns out that there are good reasons for Claire’s concerns, and a few things she needs to do before K-Child begins full-scale operations.

The Nature Of Nonprofits

Arkansas law recognizes three basic categories of organizations: governments, for-profit businesses, and nonprofits. Each category has distinct legal structures and the differences are significant under the law. The most notable characteristic of a nonprofit organization is that it cannot distribute its earnings to the individuals who control it. Unlike a for-profit entity, a nonprofit does not have private owners or shareholders who benefit personally from the activities of the organization. In its definition of a corporation exempt from taxation, section 501(c)(3) of the Internal Revenue Code states that “no part of the net earnings . . . inures to the benefit of any
private shareholder or individual.” This means that no part of
the net earnings of the organization may be used to benefit a
private shareholder or individual. A nonprofit may earn a profit
and may even engage in commercial activities. (See discussion
of unrelated business income tax, below.) For example, the
Girl Scouts may sell cookies and the Red Cross may buy, sell,
and hold real estate. Profits or earnings from these endeavors
must be used in a way that furthers the nonprofit purpose of the
organization. Nonprofit status is conferred by the State, but to
be recognized as exempt from income tax, an organization must
apply to the Internal Revenue Service (the “IRS”).

This manual is written primarily for the incorporated
nonprofit charitable organization that qualifies for tax-exempt
status under Internal Revenue Code section 501(c)(3). Like
most charitable groups that intend to solicit donations from the
general public, K-Child will probably choose to incorporate and
apply for IRS recognition of its 501(c)(3) status. It is possible,
however, to operate as a nonprofit under a less formal structure.

Creating an Unincorporated Nonprofit Association

Under Arkansas law, K-Child could become an unincorporated
nonprofit association without taking any formal steps. A group
of at least two people agreeing to act for a common, nonprofit
purpose is considered an unincorporated nonprofit association. Although it has not filed any formal documents with the state, a nonprofit association is a legal “person,” that is, it can own property and sue (or be sued) separate from its members. This means that, if K-Child was a nonprofit association, Claire could open a checking account and enter into contracts in K-Child’s name instead of her own. Even better for someone like Claire, K-Child’s status as a nonprofit association would limit some of her liability for the organization’s obligations.

A person is liable (or has liability) if she may be held legally responsible to another person or to society. Liability is an important idea in the law. If there is a lawsuit and a jury finds that a person is liable, the court can order that person to pay money to another person. As long as Claire tells the people she deals with that she is acting on behalf of K-Child, and not herself individually, she should not be liable for its debts.

While several people have volunteered to help K-Child achieve its goals, it is not clear that anyone other than Claire can be considered a member of the organization. For this reason, it is a good idea for Claire to undertake some formal steps so that everyone can be sure that K-Child is clearly a nonprofit association under Arkansas law. First, she should contact the other potential members and discuss the overall purpose of the
organization. Then, they should put their understanding in writing, stating the organization’s name, describing its purpose, listing its members, and stating what property belongs to the association. This organizing document does not need to have any particular name, but it may be called the “Articles of Association,” or “Constitution.” It should be signed and dated by at least two members. Because Claire’s organization already has significant funding and numerous volunteers, she may want to seek the help of an attorney to help K-Child come up with a more detailed organizing document. While state and Federal laws allow K-Child to operate as an unincorporated nonprofit association, most nonprofit associations choose to incorporate. The incorporation process is described below.

**Incorporating as a Nonprofit**

Although K-Child could continue to operate as an unincorporated nonprofit association, it will probably decide to become a corporation, a more formal structure that adds stability and credibility to the organization. The primary advantage of incorporation is that it limits the liability of board members and managers of the organization. Another benefit is that the law of corporations is better developed than the law of unincorporated nonprofit associations. Consequently, an incorporated nonprofit
has a clearer legal position and its directors, officers and members are more likely to be insulated from liability. Foundations, for-profit corporations, and other donors may be unfamiliar with unincorporated nonprofit associations and, therefore, more comfortable giving to organizations that have incorporated. Similarly, banks and other businesses may be disinclined to deal with unincorporated groups. For these reasons, an organization like K-Child that intends to seek funding and expand its services will usually incorporate.

This is the point at which many groups like K-Child begin to wonder whether they need the services of an attorney. While it is certainly possible to establish a tax-exempt nonprofit corporation without legal assistance, an attorney who is knowledgeable about nonprofit issues can be a big help. Incorporating as a nonprofit is a fairly simple matter of drafting adequate articles of incorporation and filing with the Arkansas Secretary of State. After incorporating, most nonprofits seek recognition of their tax-exempt status from the IRS, a process that is considerably more complicated than incorporation. Legal representation, while not strictly necessary, can ease the burden of dealing with the IRS and free the group to attend to the many tasks inherent in getting a new nonprofit off to a good start.
Drafting and filing articles of incorporation

To incorporate as a nonprofit, K-Child will need to draft articles of incorporation and file them with the Arkansas Secretary of State. Under Arkansas law, the articles of incorporation must include:

♦ the name of the organization;

♦ the name and address of the corporation’s incorporators;

♦ a statement as to whether the organization will have members (see discussion of membership below);

♦ an explanation of how the organization’s assets will be distributed if it shuts down;\(^\text{10}\) and

♦ the name and address of the corporation’s first registered agent.\(^\text{11}\)

The Articles may also include:

♦ a statement of the organization’s purpose,

♦ the names and addresses of the initial directors, and

♦ provisions related to the management and governance of the organization.\(^\text{12}\)
The Articles must declare whether the organization is a public benefit, mutual benefit, or religious corporation.\textsuperscript{13} Usually a nonprofit that intends to seek recognition of 501(c)(3) tax status will be either a public benefit or religious corporation. A mutual benefit corporation is an organization such as a trade association or chamber of commerce that exists primarily to advantage its members. Since K-Child’s purpose is to serve the children of Little Dipper and it is not a religious organization, it will be a public benefit corporation.

The office of the Arkansas Secretary of State is a useful resource for developing nonprofits. Its website, at \texttt{www.sos.arkansas.gov}, offers general information about nonprofit corporations and accommodates on-line filing of articles of incorporation. Articles of incorporation also may be filed at the Secretary of State’s office in the Arkansas State Capital building, room 256. The filing fee is $50.\textsuperscript{14}

\textit{Holding an organizational meeting}

Once the articles of incorporation are filed, the incorporators or initial directors of the newly formed corporation should hold an organizational meeting.\textsuperscript{15} The purpose of this meeting is to elect officers, adopt bylaws and conduct any other necessary business. The directors need to choose an “accounting year” and
authorize bank accounts and signatories, the filing of documents necessary to obtain tax-exempt status, and other actions necessary to begin operations. An organization’s “accounting year” is the annual period that the organization uses for computing its income and keeping its books. Thus, the organization should choose an accounting year that corresponds with its natural cycle of financial activity. The organization can choose the normal calendar year, which would mean an accounting year that begins January 1 and ends December 31, or it can choose another 12-month period that ends on the last day of any month other than December. If initial directors are not named in the articles of incorporation, then the incorporators should elect a board of directors, which will then proceed to conduct the necessary business.

**Arkansas reporting requirements**

A new law passed by the 2007 General Assembly requires nonprofit organizations to make an annual disclosure to the Secretary of State.\(^{16}\) By August 1 of each year, K-Child must file a statement with the Arkansas Secretary of State that provides the following information:

- The name of the corporation;
- The corporation’s place of incorporation;
- The name and address of the corporation’s registered agent for service of process;
• The address of the corporation’s principal office;
• The names of the corporation’s principal officers; and
• The names and addresses of the corporation’s directors.\textsuperscript{17}

If K-Child fails to file this statement within sixty (60) days after it is due, the Secretary of State is authorized to commence a proceeding to dissolve the corporation.\textsuperscript{18}

**Deciding Whether to Have Members**

Some nonprofits choose to have members; others do not. The primary reason for members is to allow a large number of people to be involved in the governance of the organization by electing the board of directors and deciding other major issues. Members of a nonprofit organization may be compared to shareholders in a for-profit, but they do not hold stock and they do not really own the organization. If anybody can be said to “own” a nonprofit, it is the public served by the organization. Members and directors represent the interests of that public.

Membership can be a good way to build support for the mission of the organization, but only if members are motivated to stay informed and play a meaningful role. Recruiting members and keeping them informed and involved can be time-
consuming and expensive. A membership organization should have a good plan for keeping up with members and ensuring that they are involved enough to take their role, including election of the board of directors, seriously. The Arkansas Nonprofit Corporation Act of 1993 requires a nonprofit corporation to maintain a membership list, including an address for each member and the number of votes to which each member is entitled.²⁹

Some organizations have “members” who are actually donors or participants with no power to elect the board of directors or otherwise participate in governance. For example, a nonprofit athletic club may charge “membership” dues to use its facilities, but not afford such members a vote. For the sake of clarity, it is better to find a term other than “member” to describe such persons. At a minimum, the organization should make it clear that these are non-voting memberships.

In most nonprofits without members, the board of directors is self-perpetuating, meaning that the board members themselves elect the board. For this system to work well, most boards will need to make an ongoing effort to recruit new members and otherwise provide for a turnover of power.
Tax-Exempt Status

As it now stands, K-Child may have to pay income taxes on money that the organization receives. In addition, anybody who makes a gift to K-Child will not be able to deduct the donation from his or her federal or state income taxes. Of course, both of these issues could make it much harder for the organization to raise money, do its work, and achieve its goals. For these reasons, K-Child should seek IRS recognition of its tax-exempt status immediately.

Attaining tax-exempt status

An organization may be exempt from state and federal taxation if it is organized and operated “exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international sports competition…or for the prevention of cruelty to . . . animals.” These organizations are commonly called “501(c)(3) organizations” because of the section of the U.S. tax code where the exemption is found. Because it is organized for the purpose of educating children about good nutrition and physical activity, K-Child will probably qualify under section 501(c)(3). Both unincorporated associations and incorporated nonprofits may seek recognition of 501(c)(3) status from the IRS.
K-Child will apply for tax-exempt status by using IRS Form 1023. Before K-Child may complete Form 1023, though, it must obtain an Employer Identification Number (EIN) from the Internal Revenue Service. An Employer Identification Number is an organization’s account number with the IRS, similar to an individual’s Social Security Number. It is needed even if K-Child does not plan to have any employees. K-Child can apply for an EIN by calling 1-800-829-4933, submitting Form SS-4, or visiting the IRS website at www.irs.gov.

At twenty-eight pages long, Form 1023 is rather complicated, seeking information regarding the nonprofit’s structure, operations, finances, fundraising activities, and membership. It also requires that an organization’s organizing document contain a “Purpose Clause” and a “Dissolution Clause.” Many nonprofits seek an attorney to help them obtain tax-exempt status, often the same attorney who helped to draft the organizing documents. Once the IRS issues a Tax Determination Letter, the nonprofit may also apply for an exemption from Arkansas income taxes using Form AR1023CT, a form much shorter than the federal version.

Keeping tax-exempt status

After attaining tax-exempt status, K-Child will be subject
to certain federal requirements and restrictions with which it must comply in order to maintain its tax-exempt status. These requirements and restrictions have similar objectives. They are designed to ensure that K-Child is conducting its affairs in a manner that furthers the purpose for which it was organized, educating children about good nutrition and physical activity. They are also designed to discourage K-Child from engaging in activities that cause K-Child to look more like a for-profit company than an organization with a charitable purpose.

**IRS Form 990; Annual notice required under the Pension Protection Act of 2006**

Each year most tax-exempt organizations must file a Form 990. Form 990 is often called an “informational return,” as it requires the organization to provide the IRS with information about its receipts, disbursements, expenses, and all other information required under section 6033 of the Internal Revenue Code. Form 990 is not a typical tax return, in that it is not used by the IRS to determine the amount of tax owed. Rather, it is a mechanism by which the IRS is reassured that K-Child deserves to keep the tax-exempt status that it has been granted.

The following tax-exempt organizations do not have to file a Form 990: (1) “churches, their integrated auxiliaries, and conventions or associations of churches;” (2) certain
organizations that are not private foundations and whose yearly gross receipts normally do not exceed $5,000; and (3) “the exclusively religious activities of any religious order.” The IRS also has the discretion to exempt other organizations from this filing requirement, and it has done so by increasing the $5,000 yearly gross receipts limit to $25,000 for many tax-exempt organizations that are not private foundations.

Even though there are several organizations that do not have to file a Form 990, the Pension Protection Act of 2006 (the “PPA”) created new notification requirements for organizations whose yearly gross receipts normally do not exceed $25,000. Under section 1223 of the PPA these organizations must provide, in electronic form, the following information: (1) the legal name of the organization; (2) any name under which the organization operates or does business; (3) the organization’s mailing address and website address (if it has one); (4) the organization’s taxpayer identification number; (5) the name and address of a principal officer; and (6) evidence of the continuing basis for the organization’s exemption from the Form 990 filing requirement in section 6033 of the Internal Revenue Code.

The Act also describes the penalty for an organization’s failure to file a Form 990 or failure to comply with the Act’s notification requirements. If an organization does not comply
with the Form 990 or notification requirement for three consecutive years, the organization’s tax-exempt status will be revoked.\textsuperscript{31} An organization whose status is revoked must re-apply if it wants to have its tax-exempt status reinstated.\textsuperscript{32}

\textit{Section 4958 intermediate sanctions}

As mentioned above, Internal Revenue Code section 501(c)(3) states that “no part of the net earnings of [a tax-exempt organization may inure] to the benefit of any private shareholder or individual.” This restriction is often referred to as the inurement limitation. The inurement limitation addresses transactions between an organization and “insiders,” such as founders, directors, and officers. Inurement occurs when the insider receives a disproportionate benefit as a result of his or her control over the organization. Examples of a disproportionate benefit are paying excessive compensation to one of K-Child’s officers or making a below-market rate loan to one of K-Child’s board members. Under the inurement limitation, if an insider receives a disproportionate benefit, the only sanction is a severe one, revocation of the organization’s tax-exempt status.

Because of the severity of the sanction, the IRS historically did not enforce the inurement limitation very often. There was a concern that an organization would have to suffer a
disproportionately severe punishment for a small inurement violation. Things changed in 1996 when section 4958 was added to the Internal Revenue Code. Section 4958 is known as “intermediate sanctions” legislation because it creates a middle ground between no sanction and the ultimate sanction (revocation of tax-exempt status) for violation of the inurement limitation. Rather than revoking an organization’s tax-exempt status for engaging in an inurement transaction, section 4958 imposes a lighter penalty, an excise tax. This excise tax is imposed on the individual who benefited from the transaction, and the tax is twenty-five percent (25%) of the amount of the excess benefit that the individual received. A lesser excise tax penalty may be imposed on any officer, director, or trustee of the organization if she knowingly allowed the organization to engage in the transaction; however, she will not be subject to the penalty if she can show that her involvement in the transaction was “not willful and [was] due to reasonable cause.”

A significant aspect of the section 4958 intermediate sanctions is that they apply to anyone considered a “disqualified person.” An individual with a formal title, such as chairman of the board of directors, is a disqualified person. But, additionally, someone without a formal title, yet still in a position to exert substantial control over the organization, is also treated as a disqualified person. Furthermore, the family member of a disqualified person
is treated as a disqualified person for purposes of imposing the penalty, as well as certain entities in which a disqualified person owns more than a thirty-five (35%) interest.36

While the section 4958 intermediate sanctions appear daunting and penalty-oriented, most tax-exempt organizations appreciate section 4958 and its regulations. Before section 4958, an organization had no way to know whether a particular compensation package would be considered excessive compensation, in violation of the inurement limitation. The section 4958 Treasury Regulations describe a process that, if followed, will assure the organization that the payments it makes to a disqualified person, if such payments are part of a compensation package, will be presumed not to be an excess benefit transaction.37 As a result of these regulations, organizations have been more inclined to pay higher salaries to their officers and directors, since now they know how to determine whether compensation is reasonable or excessive.

Unrelated business income tax

Despite the misleading label “nonprofit,” nonprofits are permitted to earn a profit without automatically losing their tax-exempt status. The profit, however, must be used to further the organization’s tax-exempt purpose. Despite the misleading label
“tax-exempt,” tax-exempt organizations often are subject to taxation, such as the excise tax under section 4958 or the unrelated business income tax.

The unrelated business income tax is imposed when an organization engages in commercial activities that are unrelated to the organization’s tax-exempt purpose. This means that if K-Child were to sell mouse pads and paper weights decorated with the K-Child logo, K-Child probably would have to pay income tax on the revenues derived from the sale of those items. On the other hand, if K-Child were to open a store that sold health foods and snacks along with books and magazines about nutrition, the revenues from the store probably would not be subject to the unrelated business income tax, as the sale of those items would be substantially related to the performance of K-Child’s educational purpose.\(^\text{38}\) In either of the situations described above, K-Child would not lose its tax-exempt status simply because it engaged in commercial activities. However, if K-Child was to expand its sale of mouse pads and paper weights into a large scale operation of an office-supplies store, at some point its commercial activities could jeopardize K-Child’s tax-exempt status. A nonprofit that engages in commercial activities not substantially related to its charitable purpose should seek guidance from a tax professional in order to safeguard its exempt status.
Endnotes

7 A “member” is any person who, “under the rules or practices of a nonprofit association, may participate in the selection of persons authorized to manage the affairs or in the development of policy of the nonprofit association.” Ark. Code Ann. § 4-28-501(1) (Repl. 2001).
8 See I.R.S. Instructions for Form 1023 at 35 (June 2006).
9 Id. at 7; Ark. Code Ann. § 4-28-501(2) (Repl. 2001).
22 Id.
23 Id.
30 Id. at § 1223(a)(i).
31 Id. at § 1223(b)(1).
32 Id. at § 1223(b)(2).
36 Id.
37 See generally Treas. Reg. § 53.4958-6.
38 Treas. Reg. § 1.513-1(b).
CHAPTER II

The Nonprofit Board of Directors

K-Child, Inc., is Born

Mayor Hightower suggested that Claire talk to an attorney about the advantages of incorporating and getting tax exempt status from the IRS. Claire asked around and got the name of Sandy Stone, a local attorney who was familiar with legal issues related to nonprofit organizations. A few days later, Claire and Sandy met for breakfast at Dipper Diner on the Little Dipper town square. The two hit it off and Sandy was able to answer Claire’s questions and explain the process of establishing a nonprofit corporation with tax exempt status.

Claire decided to invite people interested in the project to meet and talk about whether they should incorporate K-Child and apply for tax exempt status. On the appointed date, the group gathered in the spare office offered by Reverend Bailey. Claire reviewed what she had learned from Sandy about the advantages of incorporation and the importance of being tax exempt. The group decided K-Child should pursue both.

Luckily, Little Dipper is blessed with numerous active, community-minded citizens. One of them is Tim McSwain, the town’s fire chief who also runs the little league (the “Little Dipper League,” to be exact). Another is Zoey Wright, a retired school teacher and the owner of the Little Dipper Doggy Daycare. Tim and Zoey together volunteered to help Claire draft the Articles of Incorporation. They also agreed to serve as incorporators and initial directors.
Meeting the following week, Claire, Tim, and Zoey had to make some initial decisions in order to draft the Articles. They all liked the name K-Child and came up with the following statement of purpose: to improve nutrition, fitness, and general health among the students at Little Dipper Elementary School. They agreed that K-Child would not have members. When the Articles were completed, Claire filed them with the Arkansas Secretary of State and paid the required filing fee. K-Child, Inc., was born.

After incorporating, Claire invited Tim and Zoey to join her for an organizational meeting. Reviewing a proposal from Sandy, they decided to hire her to help them get tax-exempt status from the IRS. Tim volunteered to work with Sandy during that process. The three incorporators agreed that they needed to expand the board of directors in order to provide for effective governance of K-Child. Claire, Tim and Zoey decided that twelve directors, including themselves, would be a good start. Tim and Claire volunteered to interview community members and propose a slate of candidates. Zoey, who liked to write and had served on other nonprofit boards, promised to draft some bylaws for the others to consider. The three arranged to meet again in two weeks.

In the meantime, Tim and Claire talked to prospective board members. Some had never served on a nonprofit board and asked lots of questions. What was the purpose of the K-Child board? What were directors expected to do? Would they have legal responsibilities and liabilities? Sandy provided Tim and Claire with some basic information on the role and responsibilities of the nonprofit board to support their recruitment efforts.
Introduction

If K-Child is to prosper, Tim and Claire will need to take their recruitment duties seriously. Nothing is more important to the success of a nonprofit organization than a highly motivated, well-informed, active board of directors. The first step to having a great board is thoughtful recruiting. That means the organization will determine what skills and attributes it needs on the board and then look for people who match those requirements. Prospective directors should be informed about the responsibilities of board membership, the programs of the organization, and what will be expected of them if they are selected to serve.

Role of the Nonprofit Board

The role of a nonprofit board of directors is to safeguard the public trust by providing effective governance for the organization. Nonprofits occupy a privileged position in our society. Generally, they are exempt from income tax and enjoy other significant benefits. The tradeoff is that nonprofits exist to serve the public, not to generate profits for individuals. A nonprofit organization should hold itself to the highest standards of legal and ethical behavior. While everybody concerned – board, staff and volunteers – carries this responsibility, the board of directors sets the standard and oversees compliance with it.
Legal Duties of the Nonprofit Board

Prospective board members may ask Tim and Claire about what the law expects of nonprofit board members. How much are directors expected to know about the finances and day-today running of the organization? Will directors be held liable if the board makes a poor decision or relies on bad advice? Is it permissible for a board member to work for another entity that does business with K-Child?

Even seasoned board members are sometimes surprised to learn that they have legal duties to the organization and may incur legal liability as a result of their board service. It is only fair that directors have the opportunity to understand and evaluate both the benefits and risks of being a member of a nonprofit board. Accordingly, they should be educated about their legal obligations and provided with ongoing information on the subject before they agree to stand for election.

A director has three legal duties under the Arkansas Nonprofit Corporation Act of 1993: the duty of loyalty, the duty to act in good faith, and the duty of care. These duties are derived from the law of for-profit corporations and the legal standards are basically the same.
The duty of loyalty

The duty of loyalty requires directors to act at all times in the best interest of the organization and always put the organization’s interests above their own. To ensure that directors comply with the duty of loyalty, a nonprofit should establish policies and procedures to address potential conflicts of interest between the organization and its directors.

A conflict of interest is created when a discussion or action of the board might result in a direct personal benefit to a director or create a situation in which the director’s loyalties might be divided. The Arkansas Nonprofit Corporation Act of 1993 defines a conflict of interest as a transaction with the corporation in which a director has either a direct or indirect interest. A direct interest would involve a potential loss or benefit to the director herself. An indirect interest occurs when another entity in which the director has an interest is a party to the transaction. Examples of direct or indirect interests include: a director serves on the board of two nonprofits that are competing for the same grant or contract, an organization is accepting bids for construction of low-income housing and one of its directors works for a contractor that is interested in the job, a nonprofit’s insurance agent serves on its board (the agent has a direct interest in decisions involving insurance), and a director’s friend or
family member applies for a job with the organization. If an organization cannot determine whether a director has a conflict of interest concerning a particular matter, it may be prudent to consult an attorney.

How can K-Child and other nonprofits prevent such conflicts? First, they can avoid choosing board members who have obvious conflicts, such as close relatives of staff members, those who serve on the boards of organizations that compete with them for grants or contracts, and individuals who have connections to entities that might do business with the organization. Second, they can have a comprehensive conflict-of-interest policy. A sample conflict of interest policy is provided in Appendix B. Third, each director should be asked to complete and sign a conflict-of-interest statement each year. Finally, each board member should disclose conflicts of interest when they arise and recuse from discussion and decision-making that creates a conflict.

Another way that directors should exercise their duty of loyalty is by not divulging confidential information about the organization. The common-sense key to fulfilling the duty of loyalty is to put the organization’s interests before personal interests.
The duty to act in good faith

To act in “good faith” essentially means to be honest, above-board, and to act in a reasonable manner. For example, to attempt to manipulate others in service of a secret purpose would not be acting in good faith. If a director honestly believes his actions are in the best interest of the organization, and tells the truth about his motivations, he is probably acting in good faith. The duty to act in good faith is sometimes viewed as a duty independent of the duties of care and loyalty, while others find that the duty to act in good faith is incorporated into the duty of loyalty. When treated separately, the duty to act in good faith might be used to impose liability upon a director who recklessly misleads members, yet lacks a conflict of interest. In other words, the director has acted unreasonably but has not violated the duty of loyalty. It is unclear whether Arkansas law views this duty as a freestanding duty or as an extension of the duty of loyalty.

The duty of care

The duty of care requires a director to act “with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” “Prudent” means cautious, careful and sensible. So, to the extent that an average, ordinary person would be cautious under a certain set of circumstances, a
person acting in his role as director of a nonprofit organization is expected to conform to that standard of care.

As a practical matter, the duty of care means that directors must be reasonably informed and participatory. They must pay attention, ask questions, and oversee the management of the organization in a responsible manner. Directors should review minutes, financial statements, audits, plans, policies and other board documents. Ignorance is no excuse. In fact, failure to attend meetings and participate in the decision-making process increases the possibility that a director will be held personally liable for an act of the board or the organization.

In discharging the duty of care, a director may rely on information and opinions provided by certain people the director reasonably believes to be reliable and competent, including officers, employees of the organization, attorneys, public accountants, and committees of the board. If the director knows that such reliance is unjustified, then acting on the information or opinions provided is acting in bad faith.

*The business judgment rule*

The business judgment rule applies to nonprofit and for-profit corporations. Under the rule, nonprofit directors generally will not be held liable for action or inaction taken in the role of director
as long as they fulfill their legal duties, acting in good faith and consistent with their duties of care and loyalty. Directors are not required to make the best decision every time, or even a particularly good decision. The law recognizes that governance involves a great deal of judgment and discretion. Directors are expected to make reasonable efforts to be informed and to follow the organization’s established decision-making process. A board can decrease the possibility of adverse legal consequences of a controversial or difficult decision by making a serious effort to inform itself and discussing the matter thoroughly before taking a vote. The minutes should reflect these activities, so directors can show that they met their duty of care.

Functions of the Nonprofit Board

In order to be successful, K-Child’s board will need to understand what it is expected to do for the organization. Although not all of the possible functions of a nonprofit board are discussed here, the authors have attempted to touch on the board responsibilities most vital to compliance with applicable law. The board should carry out all of these functions in compliance with the duties of good faith, care, and loyalty and with the use of good business judgment.
Providing for the recruitment and training of board members

Tim and Claire may be in a hurry to fill K-Child’s board slots, but time and effort spent in recruiting the right board members ultimately will benefit the organization’s mission. Before they start recruiting, Tim and Claire should be able to answer some basic questions such as what the organization intends to accomplish and what will be expected of its board members. Tim and Claire should be able to communicate their enthusiasm for K-Child’s mission in a few sentences. They also need to have a clear understanding of what the K-Child board should look like, what characteristics, skills and talents will enable the group to fulfill its mission.

Once elected, K-Child board members will need orientation and ongoing training. Initial orientation should include: a thorough grounding in the history and mission of K-Child; a review of governing documents, policies and procedures; programs; and a presentation about the purpose, legal duties, and role of the board of directors. Board training should not stop there. One way for K-Child to develop the knowledge and skills of board members would be to set aside some time at each meeting for board training, even if only a few minutes. The directors themselves might volunteer to brush up on specific topics and provide a review for their fellow board members.
Like most nonprofits, K-Child will probably establish term limits for its board members. Therefore, recruitment of future board members will be an ongoing process.

**Deciding and protecting the organization’s mission**

Mission is the heart of any nonprofit organization. A clear understanding of mission is very important to the organization’s board, because one of the board’s fundamental responsibilities is to ensure that all of the organization’s resources are used to further the mission.

Every board member, employee and volunteer should be able to express the organization’s mission in a sentence or two, with enthusiasm. If donors and other members of the community can do the same, that is even better. For this reason, most nonprofits have a short, written statement of their mission. A common-sense approach to creating a mission statement is for the board to discuss the organization’s purpose, approach and values, and then to assign one or two members to draft several possible mission statements for the board to consider. Once the organization has a written mission statement, the board should review it annually.
Establishing governance policies and procedures

The board is responsible for creating and abiding by governance policies and procedures. Policies generally refer to rules or guidelines established by the board, while procedures describe how to implement policies.

Rules of Order

One of the first decisions K-Child’s board must make is how it will conduct its business as a group. Some nonprofits seem to pride themselves on the informality of their decision making. The agenda, developed and distributed beforehand, is largely ignored as the meeting gets into full swing. Every voice is heard and sometimes several are heard at once! A development committee report that was allotted fifteen minutes on the agenda turns into an extensive discussion of the pros and cons of golf tournaments as fundraising events. A meeting that was planned for two hours lasts for three; decision-making continues as participants with other commitments make their apologies and dribble out. Although informal decision-making may work for very small groups, the failure to adopt and follow standardized rules of order can severely undermine the effectiveness of a nonprofit organization. Too much informality is inefficient and can drive orderly, results-oriented people away from an organization.
To avoid that problem, a board should adopt and follow rules of order. The *Modern Rules of Order* by Donald A. Tortorice is a good choice for many small and mid-sized boards. Available from the American Bar Association ([www.abanet.org](http://www.abanet.org), click on “Web Store”), the *Modern Rules* are shorter and simpler than the better-known *Robert’s Rules of Order*, but meet the needs of most organizations. The *Modern Rules* would be a good choice for an emerging organization like K-Child.

Larger boards may choose *Robert’s Rules of Order*, a well known system of parliamentary procedure. *Robert’s Rules* offer several benefits. They are widely known and accepted. Because they have been around a long time, *Robert’s Rules* have been supplemented and revised numerous times and they cover just about any situation a nonprofit is likely to encounter. Unfortunately, the completeness of *Robert’s Rules* creates a burden. They are long and complicated; consequently, many groups believe they are using *Robert’s Rules*, but end up with a homegrown variation that is confusing and inconsistent. A group using *Robert’s Rules* should consider appointing a parliamentarian who will study the *Rules* and help the organization’s leaders use them correctly. The official *Robert’s Rules of Order* website, [www.robertsrules.com](http://www.robertsrules.com), is a good resource.
Bylaws

Bylaws are a nonprofit’s primary governing document. They establish the procedures by which the organization will conduct its business. Bylaws must comply with state and federal requirements, but the law allows substantial leeway for the organization to govern and manage itself in a manner appropriate to its mission and activities. Therefore, an emerging nonprofit should be wary of copying the bylaws of another organization or delegating the entire task of creating bylaws to an attorney or other outside individual. The actual drafting may be done by one person, but the entire board should discuss and decide on key provisions such as the number of board members, the length of their terms, and voting procedures. All directors should be familiar with the bylaws and take responsibility for seeing that the organization follows them. For an outline of subjects typically covered in bylaws, see Appendix C.

Minutes

Like most nonprofits, K-Child probably will elect a secretary who will be responsible to see that written minutes of each board meeting are prepared, distributed, approved and retained in a safe place. Board minutes are important governance documents because they document the work and
decisions of the board. Many nonprofits also retain minutes of committee meetings. Boards often assign the task of preparing, distributing and retaining minutes to staff members, but the ultimate responsibility for these important functions remains with the board.

**Code of Ethics**

All nonprofit boards should consider adopting a code of ethics describing the ethical principles by which the organization seeks to operate. A sample code of ethics is available from the Independent Sector, [www.independentsector.org](http://www.independentsector.org), but no sample should be adopted as is. The organization’s board and staff members should be involved in creating a code that reflects the unique values and outlook of the organization itself.

**Policy Manual**

Some organizational policies and procedures will be set out in separate documents such as bylaws. Others may be imbedded in minutes or other documents approved by the board. For example, if K-Child’s board decides that the organization will always purchase liability insurance to cover injury resulting from a K-Child event, the directors have made a statement of policy. The board and staff will be better able to comply if policies
are gathered together in a separate document or manual that references the board minutes reflecting their adoption.

**Establishing management policies and procedures**

The board’s role in the development of management policies and procedures will depend on many factors, including the size of the organization and the number of staff. Day-to-day management of a nonprofit is generally left to the staff, if there is one. The board, however, should exercise final approval over all important policies and procedures. An employee handbook, for example, is a critical document, since employment-related disputes are a common source of legal problems. Therefore, the board should approve the employee handbook and may want to hire an attorney to review it.

**Recruiting, advising, supervising and evaluating top management**

Hiring a chief executive may be the most important task a board undertakes. In addition to following general legal and ethical requirements related to hiring, a nonprofit board has a responsibility to hire the very best chief executive available. Toward that end, a board should make a careful examination of the state of the organization and its current needs before beginning a search. Directors may want to survey compensation packages offered by similar groups in order to attract good candidates.
Hiring can be complex and selecting the right chief executive is critical to the success of an organization. Therefore, a board may want to seek assistance from a paid consultant, board member, or other volunteer who is familiar with the hiring process.

The board should provide its chief executive with clear goals and priorities that lend themselves to regular evaluation. The chief executive also needs ongoing support and cooperation from the board. Usually the board chair takes the lead in this function. Alternatively, the board may appoint a small committee to work directly with the chief executive.

**Participating in a continual process of organizational planning and evaluation**

Planning and evaluation are essential to the responsible use of an organization’s resources. In addition, many donors want to know what the organization has accomplished. The planning process enables the board to establish measurable goals and objectives that support its mission. Evaluation measures progress towards those goals and objectives.

Depending on the size of the nonprofit, the requirements of its funders, and the complexity of its activities, a nonprofit may need to hire a consultant to help with planning and evaluation. This can be a good use of organizational funds because donors, particularly those who make substantial grants, are often
attracted to programs that can show concrete, measurable results. Evaluation professionals are skilled in structuring an organization’s activities so that results can be quantified and reported. Although the board may not be directly involved in program evaluation, it must be informed enough to ensure that the organization’s resources are used in service of its mission.

Assuring the organization’s financial accountability

Financial “accountability” refers to the idea that an organization’s financial activity should be ethical, easy to monitor, and easy to understand. A nonprofit receives its tax-exempt status based on the understanding that it is dedicated to providing a benefit to the public, so it must be able to show that it is using its resources and assets in furtherance of its charitable purpose. In order to maintain financial accountability, the board of directors should review financial reports and policies frequently. The board should review financial data with an eye toward ensuring that: (1) officers are not misusing funds and resources; (2) officers’ compensation is reasonable; (3) the organization is being properly managed; and (4) the financial objectives are being met.

K-Child, like other nonprofits, will probably need to recruit and maintain a finance committee that is familiar with its financial records and management systems. The board of a tax-
exempt organization is often made up of people from diverse backgrounds with different skills and expertise. Nonprofits tend to look for board members who have positions of influence in the community, represent key populations, and can raise money.\(^\text{12}\) However, these people do not necessarily have any expertise in the area of financial oversight. Nonprofits should make sure that they have some people with business and financial skills on the board. A strong, active finance committee will guide the board of directors in understanding of the organization’s financial reports and documents, making it easier for the board to maintain financial accountability and transparency.

A nonprofit board should also consider having an annual independent audit. Some funders require an audit, which is an examination of the financial statements of an organization by a qualified person outside of the organization.\(^\text{13}\) An independent audit helps to ensure that the organization’s financial statements accurately portray its financial position. Additionally, an audit adds credibility to the organization’s financial statements. If the board decides to hire an independent auditor, it should appoint an audit committee or ask the finance committee to oversee the process. An audit committee’s duties include, but are not limited to: (1) selecting the audit firm; (2) reviewing and approving the scope and cost of the audit; (3) keeping a direct line of communication with the auditor; (4) reviewing the financial
statements provided by the board; and (5) making suggestions for improving the financial statements.

Arkansas law establishes standards that nonprofit and governmental organizations must follow when managing and investing institutional funds. For example, a governing board may spend as much of an endowment fund as it “determines to be prudent,” but only for the “uses and purposes” for which the fund was established. When a donor has restricted the use of his donation, the organization must comply with the restriction and cannot release it without the written permission of the donor or, if the donor is unavailable, the permission of a circuit court with jurisdiction over the matter. This is a complex and changing area of the law, so organizations should seek expert advice if they have any question about the permissible investment or use of institutional funds.

**Developing, approving and monitoring the organization’s budget**

A budget is a financial plan. In most nonprofits, the board works with the staff of the organization to set goals and develop a plan for achieving those goals. The plan, when expressed in dollar terms, is the organization’s budget. The board should begin to prepare and review the budget well before the start of the organization’s fiscal year so that there is plenty of time to discuss plans for fundraising and spending. Depending on the
size of the organization and its programs, the board may need to seek input from the staff several months before it considers the final budget for approval. Often a substantial portion of a nonprofit’s revenues comes from sources such as grants and individual donations, which can be difficult to predict. For that reason, some organizations develop alternative budgets, also called “contingency budgets,” in addition to the expected budget. Contingency budgets reflect various circumstances that the organization may encounter, such as an unusually large grant or the loss of past funders.

*Raising money to support the organization*

Many nonprofits require each board member to raise a certain amount of money each year. Others do not expect their directors to be involved in fundraising at all. Nevertheless, it is the responsibility of the board to ensure that the organization has sufficient funds to carry out its mission. The board generally sets fundraising goals and priorities. The board must also ensure that all fundraising on behalf of the organization is done in a manner that is legal and ethical. Most fundraising professionals insist that every nonprofit board member make an annual financial contribution, on the theory that it is unseemly to ask for money to support an organization’s mission if the board members themselves do not contribute.
Representing the organization to the public

Board members are ambassadors of a nonprofit. They should be able to talk in a general way about the organization’s mission, programs and achievements. When a specific issue arises, however, the board should identify a spokesperson to discuss that matter with the public. This is particularly important if the issue is controversial or complex or if the media is involved. No individual board member should claim to speak for the organization without authorization from the board.

Endnotes

1 Ark. Code Ann. § 4-33-830(a) (Repl. 2001).
4 See Ark. Code Ann. § 4-33-831.
7 Id.
10 Ark. Code Ann. § 4-33-830(c).
The newly-elected K-Child Board of Directors got together for the first time at a reception hosted by Mayor Hightower. Tim and Claire had done a great job of recruiting and the three incorporators had a hard time choosing nine new directors from a field of twenty-five well-qualified and willing candidates. The directors were a lively group, full of energy and enthusiasm and eager to make K-Child a success. They chatted excitedly about their vision of the future of Little Dipper, which would boast the healthiest children in Arkansas.

Following the reception, the directors convened their first official meeting. After rigorous discussion, the board adopted the following statement of mission:

K-Child promotes the good health of Little Dipper children and youth by providing nutritional information and recreational opportunities for children, youth and their families.

The mood became serious when Ron Lee, the owner of a Little Dipper sporting goods store, Fitness Frontiers, asked about the liability of nonprofit board members. “I’m all for this project. I have kids of my own and I sure want to see them get away from those computer games and be more active. Still, I have to admit I’m
a little hesitant to serve on this board. Am I opening myself up to getting sued? I don’t want to lose my home, or my business, over this.”

Introduction

Many nonprofit directors are concerned about how their board service might hurt them, especially in the pocketbook. Board service is a big responsibility and it involves a certain amount of risk. Fortunately, the law provides the conscientious director with some protection, which will be discussed in this chapter. Nevertheless, a good director asks questions about legal liability, for her own protection and the benefit of the organization. Before jumping into a discussion of risks, it will be helpful to discuss the concept of liability itself and review the broad legal areas from which liability could arise.

The Meaning of Liability

Liability generally means the state of being obligated or accountable. For example, an individual or organization may be liable to perform a certain act or to pay money. A legal liability usually is enforceable through the courts.
Theories of Liability

The following summaries are not comprehensive and do not take the place of legal training. Brief overviews such as these do not examine all of the nuances related to these complex legal concepts. This synopsis is intended to help nonprofit organizations stay out of legal trouble and to realize when they might need the assistance of an attorney.

Contracts

A contract is simply an agreement between two or more parties. A “party” can be either an individual or an organization, such as a business or a nonprofit organization. Some contracts, like a purely social agreement to meet for lunch, are not legally enforceable. If properly formed, business-type contracts are enforceable in a court of law. Examples include agreements to buy, sell, lease, or perform certain work. Although people often use the word “contract” to refer to a written document, an enforceable contract may be oral, written, or even implied from the circumstances.

may file suit against Theo for breach of contract. Unless Theo has a legal excuse, such as fraud or an unexpected event leading to the impossibility of performance, the court probably will hold Theo liable for breach of contract. In any event, Theo likely will be liable to K-Child for the $2,000 payment.

**Negligence and Gross Negligence**

Simply put, negligence is “the failure to do something that a reasonably careful person would do” or “the doing of an action that a reasonably careful person would not do.” Liability for a negligent act is grounded in a legal concept known as the “duty of ordinary care.” Generally, individuals have a legal duty to use the level of care that a reasonably careful person would use under the circumstances. Certain relationships, such as a parent and child or a teacher and student, heighten the duty one person owes to another. The duty of ordinary care will apply to most volunteer activities. An individual or organization that fails to use ordinary care, and in doing so harms the person or property of another, may be liable for negligence.

Gross negligence is the failure to use even slight care. If someone participates in an act of gross negligence, that person is considered to have acted with “carelessness or recklessness to a degree that shows utter indifference to the consequences
that may result.” Clearly, gross negligence is worse, and more punishable, than ordinary negligence.

**Intentional Torts and Criminal Acts**

Intentional torts are intentional acts that interfere with the person or property of another. They include assault, battery, false imprisonment, intentional infliction of emotional distress, and trespass. The most important distinction between negligence and intentional torts is based on the meaning of “intent.” While there are different ways to define “intent,” for legal purposes the focus is on whether someone knew or was fairly certain that the particular consequences would result from his or her conduct. “Intent,” however, does not require intent to cause harm to someone or something.

For example: Suppose K-Child has organized a 5K run to raise money and to encourage the children and adults of Little Dipper to be more active. Antonio, a spectator, is waiting at the 2-mile mark of the 5K. He is looking for his friend Nancy. When he spots her he decides it would be funny to hit Nancy with a water bottle – not to hurt her, but only to catch her attention. There are hundreds of people running in the 5K, several running very close to Nancy. Antonio throws the water bottle at Nancy. The bottle hits Jade, another runner, who trips, falls, and sprains her ankle. Although Antonio did not mean to
harm Jade, if Jade can prove that Antonio should have known that the water bottle would hit someone running near Nancy, Antonio likely would be liable to Jade for battery. K-child would not be liable to Jade unless the organization itself was negligent or committed an intentional wrong through the act of one of its “agents,” such as a director or employee.

Generally, “indemnification” and other insurance coverage do not cover liability arising from intentional torts and criminal acts. Indemnification is discussed later in this chapter.

**Defamation**

A false statement of fact that tends to, or is reasonably calculated to, damage another’s reputation may form the basis of a lawsuit for defamation. Written defamation is called libel; spoken defamation is slander. In order to prove a claim of defamation, the plaintiff must show: (1) that the statement was defamatory; (2) that the statement identified or referred to the plaintiff; (3) that the defendant “published” the statement (he communicated the statement verbally or in writing to someone besides the plaintiff); (4) that the statement was false or misleading; and (5) that the plaintiff was damaged.

Nonprofit organizations, by nature of their activities, can be exposed to defamation claims. Some common scenarios out of
which a defamation claim may arise are: statements published in the organization’s newsletter or on its website, statements made by a staff member during a speech, and providing references on former employees. Since the statement must have been false or misleading, truth is an absolute defense to a defamation claim. In other words, a truthful statement cannot be defamatory. The plaintiff making the defamation claim has the burden of proving that the statement was false.

There are several steps that a nonprofit organization can take to prevent defamation suits from being filed against it and to mount a strong defense if such a suit is filed. First and foremost, when responding to requests for information about a former employee, the organization should provide only minimum information, such as the employee’s dates of employment and whether the employee is eligible for re-hire. Furthermore, the organization should limit access to personnel and client files. The organization should adopt a reference policy so that: (1) potential employees are aware that the organization may request references from former employers and provide references to subsequent employers and (2) the organization has a procedure for giving truthful, verifiable references and for keeping records of the information it provides in response to a request for information. The organization also should have a procedure for verifying the truth of potentially defamatory statements.
before providing the information on its website or dispensing the information in a speech. It would be a good idea for the organization to determine whether it has insurance coverage for defending defamation claims. Lastly, it is always a good idea to obtain legal review of potentially defamatory material before the organization publishes it.

Liability and the Nonprofit Board Member

Liability of Board Members for Their Own Actions

Arkansas law imposes legal duties on every board member, as discussed in Chapter II. If a board member fulfills his legal duties of good faith, care and loyalty, he is not liable to third parties, or to the organization, for anything he did or did not do in his capacity as a board member.8 Of course, if a board member does not exercise the duty of care and engages in an act or omission constituting negligence, he can be held personally liable for the damage he caused.9 Additionally, a board member can be held personally liable if he commits an intentional tort.10 An example of an intentional tort would be a board member getting into an argument with a volunteer, then grabbing the volunteer’s cell phone out of her hand and smashing it.
Liability of Board Members for Actions of Employees or Other Board Members

Arkansas has a tort liability immunity statute in place that is specifically intended to shield board members from liability for the negligence of others.11 This statute acknowledges that nonprofit organizations provide valuable services and assistance to Arkansans and encourages people to serve on the board of directors of such organizations so that they may function effectively.12 Thus, board members are not personally liable for damages resulting from an employee’s negligent act or omission or another board member’s negligent act or omission.13 However, if a nonprofit organization sells alcoholic beverages, beer, or wine, Arkansas law is unclear on whether board members will continue to enjoy the protection of the tort liability immunity statute.14

To demonstrate how this immunity would shield board members from liability, consider the following. Suppose K-Child has an after-school program for children. K-Child maintains a list of the authorized caregivers who may pick up the children in the program. One afternoon a woman named Judy comes to pick up one of the children, Tina. Judy is not one of the people authorized to take Tina. Unfortunately, the K-Child staff member in charge did not check the list and releases Tina to Judy. The staff member committed an act of negligence, perhaps
even gross negligence. Nonetheless, the board of directors cannot be held liable for that staff member’s negligence. K-Child, on the other hand, may be held liable depending on whether it is entitled to charitable immunity. (For more on charitable immunity, see Chapter VI.)

**Liability of Board Members for Conflict of Interest Transactions**

As mentioned in Chapter II, the board member’s duty of loyalty includes the duty not to engage in conflict of interest transactions. A conflict of interest transaction is a transaction between the board member and the organization from which the board member (or a relative of the board member) could directly or indirectly realize a personal benefit. However, simply because a board member engages in a conflict of interest transaction does not mean that she will be liable to the organization. In the following situations a board member’s participation in a conflict of interest transaction will not create liability for the board member: (1) the transaction was fair to the organization at the time it was entered into; (2) the material facts of the transaction and the board member’s interest were disclosed or known to the board of directors and the board authorized, approved, or ratified the transaction; or (3) the material facts of the transaction and the board member’s interest were disclosed or known to the members of the organization and they authorized, approved, or ratified the transaction.¹⁵
To be certain that board members are able to recognize and avoid harmful conflict of interest transactions, nonprofit organizations are strongly encouraged to adopt conflict of interest policies. A conflict of interest policy describes how the organization will handle disclosure of conflicts of interest, the duty to disclose a conflict or a potential conflict, and the actions to be taken after disclosure. It is designed to prevent persons with decision-making authority from taking actions that benefit themselves, members of their families, or their business and corporate affiliates. While the main purpose of a conflict of interest policy is to prevent board members from engaging in transactions that are not in the organization’s best interest, it serves other valuable functions. Such a policy is a way for the organization to assure the IRS that no unwarranted benefits are conferred on officers and directors; this is important because an organization’s tax-exempt status can be jeopardized if it provides unwarranted benefits, or excess benefits, on its officers and directors. Additionally, if the board adopts and is dedicated to implementing a conflict of interest policy, the board members can assure themselves that they are fulfilling their duties of care, loyalty, and the duty to act in good faith. Lastly, when a nonprofit organization has a conflict of interest policy in place, and abides by the policy, donors and the public community are more likely to have confidence in the
organization’s integrity, honesty, and mission. See Appendix B for a sample conflict of interest policy.

**Liability of Board Members for Unlawful Distributions**

Under Arkansas law a “distribution” is the payment of a dividend or any part of the income or profit of an organization to its members, directors, or officers. Arkansas law only permits distributions under certain circumstances. An organization that is a mutual benefit organization may make distributions in order to purchase its memberships but only under certain conditions. An organization is also permitted to make distributions upon dissolution, provided the organization complies with the laws governing dissolution. And lastly, an organization may make distributions if the organization is organized and operated as a “cooperative.”

If a board member agrees to or votes for a distribution not permitted by law, she will be personally liable to the organization for the amount of the distribution that exceeds the permissible amount. For example, suppose that Tim, a board member of K-Child, has been sued because he recommended that K-Child hire a child care worker who later turned out to be negligent in supervising children in the after school program. Tim made the recommendation in good faith and fulfilled his duties of care and loyalty, so Claire and other board members decide that K-Child
should reimburse Tim for his legal expenses, plus a weekly stipend of $2,000 to cover his transportation, meals, and other expenses related to the lawsuit. Under Arkansas law, K-Child is permitted to reimburse Tim for *reasonable* expenses that he incurs during trial.\textsuperscript{21} The $2,000 weekly stipend probably is not a reasonable expense. Therefore, Claire could be personally liable to K-Child for the amount of the weekly stipends paid to Tim.

However, Claire would *not* be personally liable for those distributions if, when authorizing the distributions, she complied with the legal duties described in Chapter II, the duty to act in good faith, the duty of care, and the duty of loyalty. Also, if Claire is held liable for the unlawful distributions, she would be entitled to reimbursement (1) from every other board member who agreed to or voted for the distribution without having complied with his or her legal duties, and (2) from each person who received an unlawful distribution, who, in this case, would be Tim.\textsuperscript{22}

**Indemnification**

Indemnification means that one entity agrees to cover certain losses to another. The Nonprofit Incorporation Act of 1993 allows a nonprofit to indemnify a director or employee who is made a party to a lawsuit or criminal proceeding because of her service to the organization if the director or employee meets all
of the following conditions: conducted herself in good faith; reasonably believed that her conduct was in the best interests of the organization; and, in the case of a criminal proceeding, had no reasonable cause to believe her conduct was unlawful. Unless limited by its articles of incorporation, a corporation must pay the reasonable legal expenses incurred by a director who wins a lawsuit that arose because of her board service. A nonprofit may purchase insurance to cover these costs.

Whether to indemnify and how much insurance to buy are business decisions that are the responsibility of the organization’s board of directors. Indemnification without insurance is only helpful to the extent of the organization’s assets available to cover the costs.

**Directors’ and Officers’ Liability Insurance**

Directors’ and officers’ (“D&O”) insurance coverage addresses actual or alleged wrongful acts by directors, officers, and other persons insured under the policy. Most often the person bringing a lawsuit covered by a D&O policy alleges that a board member has engaged in “wrongful acts” in governing and managing the organization. The plaintiff in such a suit may be an insider, such as an employee or volunteer, or an outsider, such as a client, donor, or governmental official. Most organizations do not have sufficient assets set aside to fulfill their promises to indemnify board members
for the legal expenses they incur in defending themselves against suits based on their work as board members. Consequently, most nonprofit organizations obtain D&O coverage so that they are better able to fulfill their promise to indemnify. Board members of all nonprofit organizations should consider whether D&O insurance, or some other coverage, is necessary and affordable for the organization. The board may even appoint an individual to serve as the manager of the organization’s insurance program.

Endnotes

2 Id.
6 Id.
7 Id.
CHAPTER IV

Volunteers

K-Child’s Directors Consider the Risks Associated with Volunteers

“We have the best volunteers in the state,” commented director Henry Gonzales over a cup of coffee before the monthly meeting of K-Child’s board. Henry was a fifth grade teacher at Little Dipper Elementary and took pride in the fact that all of his students participated in K-Child sports programs. “We had a minor accident during a K-Child bike safety course last week and that got me thinking. What will happen if someone gets injured while volunteering for us? Will K-Child be responsible for the medical bills? What if one of our volunteers hurts someone else? Is the volunteer liable? Is K-Child?”

“Chill out,” responded Zoey and Tim almost simultaneously. Zoey was accustomed to the nearly risk-free pet care business; Tim was used to the dangerous world of firefighting and felt prepared for risks.

Although Claire secretly agreed with Tim and Zoey, she was wary of factions developing on the K-Child board. She wisely decided to bring in an outsider for guidance. “Maybe it’s time for Sandy to attend one of our meetings,” Claire suggested. “She could help answer these questions.”
Introduction

Like other nonprofits, K-Child needs volunteers to achieve its mission. Volunteers are the life blood of most nonprofit organizations. Over sixty million Americans donate over three billion hours of time to organizations each year.\(^1\) Recent trends in volunteering include families participating in volunteer projects together, for-profit corporations providing volunteer teams for special events, short-term volunteer assignments, and web-based volunteerism.\(^2\) Volunteers increasingly donate highly specialized skills that nonprofit organizations need and could not necessarily afford to purchase.\(^3\)

All volunteer programs create risk of liability. This chapter discusses some of the most common risks and the scope of federal and state volunteer-protection acts. Risks associated with volunteer programs can be reduced with the use of tools such as screening and orientation, followed by ongoing training and supervision of volunteers. These preventive techniques are discussed in Chapter V.

Liability of the Organization for Acts of Volunteers

The K-Child board is wise to educate itself about the risks associated with volunteers, particularly since the organization’s
focus is on children. The children participating in K-Child’s activities and programs will see adult volunteers as trusted authority figures. Sadly, some volunteers might abuse that trust. K-Child could be liable for any resulting injury.

Where no immunity protects a volunteer organization, the organization may be subject to direct liability for negligent hiring, retention, or supervision when third parties are injured by the acts of unfit, incompetent, or unsuitable employees or volunteers. Negligent hiring litigation, which includes lawsuits arising from the acts of volunteers, is a growing problem. Volunteer organizations that work with vulnerable populations such as children and the elderly are particularly susceptible to infiltration by unsuitable volunteers with histories of violence, molestation or other unacceptable behavior. A volunteer in such an organization may have access to otherwise unsupervised children or vulnerable adults. Child molesters and other criminals sometimes use volunteer opportunities to target their victims.

The doctrine of negligent hiring requires a volunteer organization to perform reasonable investigations to determine the fitness of applicants wishing to work with the organization when members of the public are likely to come into contact with such volunteers. This rule does not necessarily impose a duty to supervise directly the activities of a properly screened volunteer
if such supervision is inconsistent with the organizational structure. The reasonableness standard of the negligent hiring doctrine is flexible enough to take into account and “balance both the unique financial character of nonprofit organizations and the availability (in terms of access and cost) of new screening techniques.”

In order to recover, an injured party must show that the organization knew, or in the exercise of ordinary care should have known, that its volunteer’s or employee’s conduct would expose members of the public to an unreasonable risk of harm. Allegations that a particular background check was “inadequate” must include evidence that an alternative background check would have discovered the employee’s propensity to engage in the conduct which caused the injury. See Chapter V for more information on recruitment, screening, training, placement and supervision of volunteers.

**Liability of the Organization to Volunteers**

Providing recreational opportunities for children, youth and families is part of K-Child’s mission, so it’s not unlikely that a volunteer will be injured during one of K-Child activity. If so, the volunteer might look to K-Child to help, particularly if he has no medical insurance himself. Volunteer claims against
nonprofits usually seek: (1) payment of medical expenses for injuries suffered while volunteering; or (2) damages for the organization’s negligence in supervising the program or activity in which the volunteer was injured. While prevention is the first line of defense (see Chapter V), a nonprofit has options for covering the cost of such claims.

The organization could acquire a volunteer accident insurance policy, which is a policy that typically pays the costs of emergency-room services and follow-up treatment to predetermined limits based on the nature of the injury. Such a policy will pay a claim regardless of who is at fault for the volunteer’s injury, provided that the injury resulted from the organization’s operations or on its premises. These policies are relatively inexpensive because they normally provide only excess coverage, which means they “kick in” only after other available insurance is exhausted, does not apply, or is subject to a deductible or co-payment provision. Essentially, a volunteer accident policy covers any additional costs, up to a limit, if the volunteer’s personal health insurance is inadequate to cover his or her medical expenses.

Another option for the organization is to obtain a commercial general liability (“CGL”) policy, which typically has a section providing coverage for medical expenses associated with
an injury arising from an organization’s operations or on its premises. If a volunteer sues the organization seeking damages for harm suffered because of the organization’s negligence, a CGL policy can usually protect the organization. A third option, a directors’ and officers’ (“D&O”) policy, may also protect an organization against claims made by a volunteer, although a typical D&O policy does not cover bodily injury or property damage.

Finally, an organization may have a Workers’ Compensation policy, which covers accidental injuries. A Workers’ Compensation policy pays for medical expenses as well as lost wages resulting from a “work-related” injury. If an organization has a Workers’ Compensation policy, it may consider including volunteers on that policy. Thus, if a volunteer is injured while “working” for a nonprofit organization, the volunteer could have his medical expenses covered. A Workers’ Compensation policy is also beneficial to the organization, as it limits injured volunteer’s remedies to the benefits provided under the policy. This means that the volunteer may not have his medical expenses covered and also bring a lawsuit against the organization. For more information on insurance, see Chapter VI.

Chapter IV—Volunteers
Liability of Volunteers to Third Parties

K-Child’s volunteers may also be concerned about their own liability for accidents or injuries occurring during K-Child activities. Volunteer service, like virtually any activity, carries some risk of personal liability for harm caused to people or property. Federal and state laws, the federal Volunteer Protection Act of 1997\(^{21}\) and the Arkansas Volunteer Immunity Act, enacted in 1987,\(^{22}\) limit this liability, but do not prevent lawsuits against volunteers.

Unless protected by state or federal law (the uncertainty of the scope of that protection is discussed below), a volunteer can be held liable if his behavior is negligent. Even when an individual is not being paid and acts with the best of intentions, he may be liable for negligence if he fails to use ordinary care, as described in Chapter III.

Volunteers may carry personal insurance that covers certain types of negligence. For example, individuals who provide transportation in their own vehicles as part of their volunteer activities may be covered for liability arising from that transportation. Some vehicular insurance policies, however, may exclude such coverage, especially if the volunteer is being “paid” with reimbursement for gas or other expenses. Alternatively, a nonprofit may have liability insurance covering acts of volunteers.
or may agree to indemnify its volunteers. A nonprofit that indemnifies its volunteers agrees to cover the costs of legal defense, fees and damage awards arising from volunteer activities.

Generally, neither insurance nor any other form of indemnification covers liability resulting from an intentional act, such as a volunteer striking a client. Of course, a volunteer is subject to prosecution if she commits a crime.

**Volunteer Protection Act of 1997**

In 1997 Congress passed the Volunteer Protection Act of 1997 (the “VPA”). The goal of the VPA is to encourage people to serve as volunteers by shielding them from liability for harm that they may cause while serving as volunteers. The VPA provides protection for volunteers of a nonprofit organization or a governmental entity. Under the VPA, a “volunteer” is an individual performing services for a nonprofit organization or a governmental entity whether she is a volunteer serving as a director, officer, trustee, or direct service volunteer. Furthermore, the individual is only treated as a “volunteer” if she does not receive (1) compensation (other than reasonable reimbursement or allowance for expenses actually incurred); or (2) any other thing of value in lieu of compensation, in excess of $500 per year.
Several conditions must be satisfied for a volunteer to benefit from the protection of the VPA; a volunteer will not be liable for harm caused while serving a nonprofit organization or a governmental entity if:

1. the volunteer was acting within the scope of her responsibilities in the organization or entity at the time of the act or omission;²⁶

2. when appropriate or required, the volunteer was properly licensed, certified, or authorized by the appropriate authorities;²⁷

3. the harm was not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the harmed individual;²⁸ and

4. the harm was not caused by the volunteer operating a motor vehicle, vessel, aircraft, or other vehicle for which the state requires an operator’s license or insurance.²⁹

A close examination of these requirements illustrates that the VPA does not provide absolute protection to all volunteers all of the time.

For example, often a volunteer’s responsibilities are vague or undefined, which makes it difficult to determine whether the
first condition has been satisfied. Furthermore, it is not always clear when it is “appropriate” for a volunteer to be authorized to act. Additionally, plaintiffs often use the third condition to their benefit by alleging “willful misconduct” or “flagrant indifference to the rights or safety of the harmed individual.” In doing so, the plaintiff makes it much more difficult for the volunteer/defendant to find protection under the VPA, often requiring the volunteer/defendant to spend time and money defending the claim.

Nonetheless, even if the above-mentioned conditions have been met, and the volunteer is entitled to the protection of the VPA, the volunteer is not necessarily home-free. Often if a volunteer is protected by the VPA, the plaintiff will sue the organization rather than the volunteer. If the plaintiff obtains a judgment against the organization, the organization may look to, or sue, the volunteer for contribution or indemnification. In other words, if a volunteer causes harm that the organization must pay for, the organization likely will demand that the volunteer reimburse the organization, whether in part or in full.

The VPA also places limitations on protection depending on the type of misconduct involved. The VPA does not protect a volunteer if the volunteer’s misconduct (1) constitutes a crime of violence or an act of international terrorism; (2) constitutes a hate crime; (3) involves a sexual offense for which she has
been convicted; (4) involves a violation of a federal or state civil rights law; or (5) occurs while the volunteer is under the influence of intoxicating alcohol or any drug. The fourth limitation may be of greatest consequence to a volunteer because most lawsuits against volunteers are employment disputes, which primarily involve civil rights claims. This is yet another reason for a volunteer to be aware of potential lawsuits and liability rather than assuming that the VPA will be her steadfast shield.

**Arkansas Volunteer Immunity Act**

Arkansas’s Volunteer Immunity Act limits the civil liability of qualified volunteers for personal injury or property damage resulting from their volunteer efforts. A “qualified volunteer” is “any person who, of free will, provides goods or services without financial compensation to or through any volunteer agency in connection with a volunteer program.” A “volunteer agency” is “any volunteer program of all departments, institutions, and divisions of state government, community volunteer organization, or any not-for-profit corporation which has received a 501(c)(3) designation from the United States Internal Revenue Service, other than one established principally for the recreational benefit of its stockholders or members.”

Under the Volunteer Immunity Act, qualified volunteers
cannot be held liable in damages for personal injury or property
damage sustained by anyone participating in or using the
services or benefits of the volunteer." In addition, a volunteer is
not liable for the negligence of another person in connection with
his or her volunteer activities.\textsuperscript{35}

However, the Volunteer Immunity Act does not eliminate
liability for qualified volunteers completely. Volunteers are
still liable when acting outside the scope of the volunteer
program,\textsuperscript{36} for gross negligence, when acting in bad faith,\textsuperscript{37} and
for negligently operating a motor vehicle, aircraft, or boat.\textsuperscript{38}
Because few cases have interpreted the Act, it is unclear how
broadly these exceptions will be interpreted. They could take
away much of the protection given by the Act. For example,
“acting in bad faith” might include any negligent act. If so, the
Act would not protect a volunteer found to be negligent.

In most instances, the federal VPA pre-empts state law.\textsuperscript{39}
Therefore, if state law provides \textit{less} protection to volunteers than
the VPA, the VPA overrides that state law. On the other hand,
if state law provides \textit{greater} protection to volunteers than the
VPA, then the state law applies.\textsuperscript{40} It is difficult to measure and
compare the amount of protection that the Arkansas Volunteer
Immunity Act provides as opposed to the amount of protection
that the VPA provides. Under the Arkansas Act, a volunteer
may be held liable when she causes personal injury or property
damage if she is covered by an insurance policy, but her liability
will be limited to the amount of coverage provided. Under
the VPA, a volunteer may be protected when she causes harm,
whether or not she is covered by an insurance policy; however,
the VPA expressly recognizes that the protection afforded to
volunteers is not protection from a suit brought by the nonprofit
organization against the volunteer. At first glance it may seem
that the VPA offers greater protection than the Arkansas Act.
Nonetheless, after considering the possibility of a suit by the
organization against the volunteer, the Arkansas Act and the VPA
may be of equal value to a volunteer.

Endnotes

1 Giving and Volunteering in the United States (2001), study by the United States Department of Labor
programs/research/gvresources.html.
2 Melanie L. Herman et al., Managing Risk in Nonprofit Organizations, A Comprehensive Guide
3 Id. at 151.
4 See Chapter VI, Charitable and Governmental Immunity.
6 Mark C. Lear, Just Perfect for Pedophiles? Charitable Organizations That Work with Children and
Their Duty to Screen Volunteers, 76 Tex. L. Rev. 143, 143 (1997).
7 Id. at 181.
8 Id.
9 Id.
10 Smith, 63 Ark. App. at 135, 976 S.W.2d at 398-99. The court distinguished negligent hiring from
liability under the theory of respondeat superior, which requires the tortious employee’s act to be
within the scope of the employment. Id. Negligent hiring, on the other hand, is premised upon the
employer’s negligence being the proximate cause of the plaintiff’s injury. Id.
11 See Mark v. Borough of Hatboro, 51 F.3d 1137, 1155 (3rd Cir. 1995) (finding that because a
volunteer fire company did perform criminal background checks on each applicant, any allegation
that the need for psychological screening was “obvious” would have to measure the extent to which
psychological screening provides a better benchmark for discovering potential arsonists than the police background check already employed); accord Porter v. Harshfield, 329 Ark. 130, 138-39, 948 S.W.2d 83, 87 (1997) (recognizing that the mere fact that a man has engaged in homosexual conduct “in no way indicates that he would commit a sexual assault”).

13 Id. at 108.
14 Id. at 109.
15 Id. at 108-09.
16 Id. at 109.
17 Id.
18 Id. at 112; see also Chapter VI for more information on D&O policies.
19 See Herman et al., supra note 2, at 109.
20 Id. at 111; see also Chapter VI for more information on Workers’ Compensation.
23 42 U.S.C. § 14501 et seq.
33 See Ark. Code Ann. § 16-6-103(2).
35 Ark. Code Ann. § 16-6-104(a) (Repl. 1999).
36 Ark. Code Ann. § 16-6-104(b).
37 Ark. Code Ann. § 16-6-105(2).
38 Ark. Code Ann. § 16-6-105(3).
40 42 U.S.C. § 14502(a).
CHAPTER V

Personnel Issues in Volunteer Management

K-Child Learns to Recruit and Supervise Volunteers

News spreads fast in Dipper County, and the K-Child board is especially attuned to the local grapevine. The next meeting was abuzz with news of what had happened in the nearby city of Ursa Minor.

Following the lead (as always) of Little Dipper, Ursa Minor had instituted its own children’s fitness organization called the “Star Bears.” Unfortunately, the Star Bears’ first annual track meet was the scene of a small crime wave. It seems that the volunteer in charge of safekeeping the participants’ property was a kleptomaniac.

Henry quickly brought up the issue of liability. “Most of our volunteers are terrific, but it’s always possible we’ll get a bad apple. And, even the best volunteer can have a bad day or take on something he can’t handle,” said Henry. “We have to take our volunteers and their activities seriously; essentially, they’re unpaid employees.”

Claire turned to Ron, who was known to have his own personnel problems in the retail sporting goods business. “Ron, you have dealt with employee supervision and screening before. Can you help us learn how to screen and supervise volunteers?”

Ron replied sheepishly, “Honestly, that’s something my wife Kim handles as our store’s Human Resources Officer. What
if I ask her to prepare a summary of personnel issues related to volunteer management for the next board meeting? We’ll make a presentation and let the board decide what else we’d need to know about these matters.”

The board enthusiastically supported Ron’s proposal. They all hoped that Kim would be willing to help!

Introduction

The K-Child board is onto something here. Volunteer managers have many of the same concerns as employers. Establishing a comprehensive volunteer management program will help K-Child avoid trouble and keep its volunteers happy and productive. Board members will also gain some valuable information and skills that will serve them well if they later decide to hire staff for K-Child.

The most common causes of legal action against nonprofits, and their directors and officers, are related to employment. Complaints include discrimination, wrongful termination, sexual harassment, and wage and hour disputes. Any organization with employees should be familiar with basic employment law, a subject that is beyond the scope of this publication. Because volunteers should be treated with the same fairness and respect as employees, this book will touch on those personnel issues of particular relevance to volunteer management.
A nonprofit also has a responsibility to protect its employees, clients, and the general public from harm caused by its volunteers. Consequently, an organization should take the same care in recruiting, screening, training, supervising, and evaluating volunteers as it does paid employees. A comprehensive volunteer management program will help minimize an organization’s legal exposure.

The essence of volunteer service is that it is given freely. Sometimes a nonprofit may unknowingly make an employee out of a volunteer by giving cash, gift certificates, or other taxable benefits. Non-cash gifts of nominal value are generally safe, but cash equivalents are taxable and cast doubt on an individual’s volunteer status. More information is available at the IRS website, www.stayexempt.org, at the link to the workshop on employment issues.

From Recruitment to Placement

Recruitment

Most nonprofits are in constant need of volunteers, so they need a vigorous and ongoing recruitment program. A successful recruitment effort will look beyond the “usual suspects” and seek volunteers from all walks of life. There are talented people
everywhere who do not volunteer simply because they haven’t been invited or haven’t found a program that fits their interests and needs. Volunteer programs should strive to be as diverse as the communities they serve in terms of race, religion, socio-economic status, age, sex and disability. An organization’s mission or programs, however, may necessitate restricting volunteers. For example, a church-based project may require volunteers to be members of the congregation. Such restrictions should be implemented only when necessary to achieve the objectives of the program. Children and teenagers can be great volunteers, but minors should be required to submit written consent from their parents or guardians.

As part of its recruitment efforts, an organization should consider making presentations to local clubs and other groups. By reaching out to the community in this way, an organization not only recruits new volunteers, but also has an opportunity to inform the public about the organization’s mission and activities. An organization that chooses to make presentations as part of its recruitment efforts should consider the following tips.

• Target groups should be chosen carefully. The best groups are (1) those whose members regularly participate in community service, and (2) those whose members likely have a common interest in the mission or activities of the organization.
• The presenter must be carefully selected; she must be able to explain what the organization does and what the organization needs from potential volunteers. The presenter should directly ask the audience to volunteer.

• The presenter should use visual and auditory aids, if possible. There are many different learning styles; audiences are much more likely to respond when they are engaged and enjoy what they are learning. A University of Minnesota study shows that people are 43% more likely to be persuaded with the use of visual aids.

• The presenter must be prepared for audience members to volunteer by taking along brochures, descriptions of jobs that need to be filled, sign-up sheets, and other necessary materials. The presenter and/or other members of the organization should be sure to get contact information for anyone expressing interest in volunteering.¹

Job Descriptions

Volunteer job descriptions serve several purposes. They set out what a particular volunteer is expected to do and define what a volunteer is authorized to do on behalf of the organization. A well-written job description will clarify the risks associated with
the position, minimize misunderstandings, and guide decisions about screening, training and supervision. If a volunteer goes beyond the scope of his designated duties and injures someone in the process, a job description could help insulate the organization from liability.

A comprehensive volunteer job description may include the following elements: purpose, duties, qualifications (including degrees, licensure or certification, if necessary), supervisor, where volunteer activities will take place, number of hours required per week or month, specific days and times the volunteer will be needed, and required references and background checks. A job description might also include prohibited activities, such as inviting clients to the volunteer’s home or lending money to clients. Some organizations include a term of service, such as two years, renewable by mutual agreement. A well-written job description will help a potential volunteer decide whether the job is right for her and will also enable the organization to evaluate the match between volunteer and position.

Before placement, job descriptions are an important screening tool. Specific information about necessary abilities, skills, knowledge and personal qualities will help match volunteers to appropriate volunteer duties. After placement, job descriptions provide structure for training, supervision, and evaluation.
Volunteer Applications

An application form is an important tool for recruiting and screening volunteers, and matching potential volunteers to the organization’s needs. A smaller nonprofit might choose to have one general application form, but many organizations will need specialized forms for particular volunteer positions. An application form might include the following inquiries, tailored to the needs of the organization and the role for which the volunteer is applying.

- Identification: name, address, phone numbers, email address.
- Specialized identification that may be required for some volunteer positions and background checks: Social Security number, driver’s license number, insurance information.
- Qualifications and Interests: educational background, occupation, relevant skills and knowledge.
- Limitations: health concerns, time constraints.
- References: employers, teachers, friends.

When appropriate, volunteers should also provide written permission to conduct a background check. References are particularly important if the volunteer is not well known to the organization or if he
will not be directly supervised at all times. The application form also should include a certification that the information provided is true and a waiver of any right of confidentiality.

**Screening**

Volunteer screening procedures vary greatly depending on the nature of the organization’s activities and the risks involved in the specific volunteer position. Common categories of screening include: general references, health, criminal background and driving records. Because of privacy concerns, background checks should be no broader than necessary and should be tailored to the requirements of a specific volunteer position. In most circumstances, an organization should avoid conducting a background check on a volunteer if the volunteer’s tasks are considered low risk, or she is not working with vulnerable client populations, such as children, dependent adults, and individuals with disabilities.²

If a volunteer is performing a service that ordinarily requires a specific license or other qualification, the organization should ensure that the volunteer has the appropriate credentials. Specialized insurance may also be necessary. For example, a volunteer attorney should be licensed to practice law and have malpractice insurance that covers volunteer activities.
Screening usually starts with a job description and corresponding volunteer application form, followed by a personal interview and appropriate background checks. For some positions, such as food preparation or working with medically fragile clients, health screening may be necessary. Similarly, if the volunteer position requires certain physical abilities, such as lifting, the organization may require the applicant to bring a medical release to demonstrate that he can safely perform the necessary tasks.

Organizations must be particularly careful in screening volunteers who work with children or other vulnerable populations. In addition to conducting a criminal background check, an organization can find out more about a potential volunteer by asking for addresses and employers for the past several years. This information should be verified and if the applicant has moved or changed jobs frequently, the applicant should provide an explanation. Frequent moves sometimes signal a serious problem.

A nonprofit should decide what screening procedures are appropriate for each volunteer position and enforce those procedures uniformly. Any potential volunteer who refuses to cooperate with reasonable and necessary screening should be disqualified. It is both risky and discriminatory to make
exceptions. If the prescribed screening is unnecessary, the screening policy should be changed, not ignored.

**Negligent Hiring**

Negligent hiring is a doctrine that imposes a duty on employers to conduct *reasonable* investigations of potential employees to determine whether a potential employee would pose an unreasonable risk of harm to others. The idea is that if the employer, through reasonable efforts, could have obtained information that would have warned the employer that a potential employee was unfit for employment, the employer should be held responsible for any harm that that employee causes. Although this doctrine traditionally has been applied to employer-employee relationships, there is a strong argument that it does, or should, apply to organization-volunteer relationships. The argument is that a volunteer is an instrument of the organization’s charitable activity and is acting under the guidance of the organization, and this is sufficient to establish an “employment” relationship. Consequently, it is within the realm of possibility that an injured party could make a claim of negligent hiring against a nonprofit organization for injuries caused by a volunteer.

In the interest of safety and risk management, nonprofits
should examine their screening techniques to determine whether those techniques are as effective as they should be. After such an examination, nonprofits should at least consider the feasibility and/or necessity of using more extensive or advanced screening resources. Having a good screening system in place is a precaution that may be well worth an organization’s time and money.

**Health Screening**

Depending on the organization and the duties of its volunteers, it may be necessary to conduct health screening of prospective volunteers. For example, Arkansas Children’s Hospital requires that all volunteers who have direct contact with patients must provide a current tuberculosis (TB) skin test. It is particularly important to obtain an individual’s consent before conducting any health screening, especially drug or blood screening.

**Resources**

Many companies, like ChoicePoint, DrivingRecords.com, and TC logiQ, offer a wide range of background screening services, such as driving records, social security number validation, personal reference checks, civil and criminal court records, professional credential validation, workers compensation reports, and education verification. Outsourcing extensive background
checks to commercial search services can be expensive, but it can save time and resources. All professional licensing boards in Arkansas provide a license verification service. These licensing boards are listed on the state website at www.arkansas.gov. Most of these licensing boards charge a fee to verify the status of a professional’s license.

Keep in mind that a suit alleging negligent hiring would be based on the nonprofit’s failure to conduct a reasonable investigation of a potential employee. If the cost to conduct background checks is much greater than the organization can afford, requiring such a background check likely would be unreasonable and the organization would not be liable for negligent hiring.

**Criminal Background**

The Criminal History for Volunteers Act, enacted in April 2005, specifically authorizes volunteer organizations in Arkansas to request and receive criminal background information from the state police department and the Arkansas Crime Information Center (the “ACIC”). Such criminal background information includes all records of an individual’s Arkansas felony arrests, criminal convictions, and whether the person is a registered sex offender. To be eligible, the volunteer organization must first register with the Arkansas State Police Department.
Currently, the State Police charge a $11.00 fee for conducting criminal background checks on behalf of registered volunteer organizations.\textsuperscript{14} Criminal background information from the Federal Bureau of Investigation is also available if the volunteer organization submits a copy of the minutes from its most recent board meeting that lists offenses that it considers sufficient to disqualify a volunteer applicant.\textsuperscript{15}

Once a volunteer organization is registered with the State Police, it must make its request for criminal background information through the State Police Identification Bureau (the “Identification Bureau”).\textsuperscript{16} This can be done through the Identification Bureau’s website at \url{https://www.ark.org/criminal/index.php}. The requesting organization must provide its name, the identifying information of the volunteer or applicant, and a form signed by the volunteer or applicant authorizing the release of criminal history information.\textsuperscript{17} The Identification Bureau will then conduct the search through the ACIC records.\textsuperscript{18} Upon completion of the state records search, the volunteer organization may then ask the Information Bureau to conduct a national criminal information search through the FBI.\textsuperscript{19} However, only the Information Bureau can view the FBI report, and it will then notify the volunteer organization of whether the volunteer or applicant meets the qualifications already submitted for serving as a volunteer with the organization.\textsuperscript{20}
All information that the volunteer organization receives in response to a criminal background check is confidential. Any organization that obtains criminal background information is subject to prosecution for a Class A misdemeanor if it knowingly releases such information to any unauthorized volunteer organization or person or if it obtains the information for an unauthorized purpose.

**Free Resources**

While full criminal background checks will indicate whether an individual is a registered sex offender in addition to having other convictions, internet searches of registered sex offenders are available to the public for free through the ACIC website, [www.acic.org/soff/index.php](http://www.acic.org/soff/index.php). This registry provides only the names of those sex offenders who have registered and who have been assigned a risk level of 3 (high risk) or 4 (sexually violent predator). Information about sex offenders from other states is available through the respective state websites or through the National Sex Offender Public Website, available at [www.nsopr.gov](http://www.nsopr.gov). The national website includes access to information about offenders who have been convicted of a criminal offense against a minor or a sexually violent offense.
**Privacy Concerns**

If an organization plans to conduct any screening of a prospective volunteer, that individual’s privacy will be jeopardized. Nonprofits cannot ignore this privacy issue, since an organization’s screening techniques could work as a deterrent to innocent individuals wishing to volunteer.\(^{26}\) An organization should strive to conduct the least invasive screening possible. On the other hand, an organization must recognize that the safety of its clients, especially if they are members of a vulnerable population, is extremely important.

A good practice for a nonprofit is to advise the prospective volunteer about its screening process and to request written permission from the individual to conduct a background check.\(^{27}\) Additionally, if the organization uses a written application form, the signature block should include a statement of consent to verification of the information on the application and a waiver of any rights to confidentiality.\(^{28}\)

**Management**

A nonprofit generally should treat paid employees and volunteers similarly when it comes to training and supervision. Like an employee, a volunteer should be prepared to undertake her assigned duties and should be given the support she needs
to perform well. If necessary, a volunteer should be disciplined and even terminated. Some policies, such as attendance requirements, may be quite different for volunteers than for employees. Nevertheless, basic standards for job performance and behavior should be enforced across the board. Many nonprofits have far more volunteers than employees, so volunteers may be the primary force behind the organizations’ effectiveness, reputation and general corporate culture.

**Training and Supervision**

Volunteers in most positions need comprehensive orientation before they go to work. By conducting an orientation program, the organization reduces the risk that a volunteer will behave inappropriately. An orientation program also increases the likelihood that a volunteer will understand the organization’s mission, policies, procedures, and expectations. Following is a list of topics commonly covered during volunteer orientation:

- Mission and purpose of the organization;
- Identifying and reporting abuse;
- Confidentiality;
- Working with clients who have physical impairments;
- Definitions of appropriate and inappropriate behavior;
• Expectations for volunteer interaction with families and caregivers;

• Emergency exit procedures;

• Depth of staffing (to ensure that volunteers understand that they are required to work in pairs or groups with clients);

• Prohibition against fraternization with clients;

• Drug and alcohol policy;

• Sexual harassment policy; and

• Consequences of violating the organization’s rules and procedures.  

The organization should provide written materials on these topics along with the orientation presentation, compiled into a volunteer handbook for easy reference.

In addition to the orientation program, a nonprofit should offer specific on-the-job training to provide volunteers with the information and skills necessary to perform their assignments. The timing and methods of such training should be appropriate to the complexity of the position and the capabilities of the volunteer. Furthermore, if the volunteers will be working with clients from a vulnerable population, it is very important for the organization to prepare the volunteers to address abuse-related
issues, such as (1) identification of abuse; (2) the actions to be taken if a volunteer suspects a service recipient has been abused; and (3) the volunteer’s legal responsibilities.\textsuperscript{32} The organization should also consider making continuing education available to its volunteers, either by providing educational programs or recommending educational programs offered by other groups.

A nonprofit also must consider the type of supervision its volunteers require and how it will be accomplished. Nonprofits may have a volunteer coordinator to supervise volunteers or may appoint other staff members.\textsuperscript{33} In any event, the supervisor should dedicate sufficient amount of time to answering questions, addressing issues, and providing guidance to volunteers. In an all-volunteer organization, the supervisors themselves will be volunteers, presumably those with the most experience, skill or history with the organization.

K-Child, for example, has no paid staff and works with children, a population that is vulnerable to accidental and intentional injury. The K-Child board will need to develop policies and procedures to protect the children in its program. One concern is who will supervise the release of children to authorized caregivers.\textsuperscript{34} The responsible volunteer must know who is authorized to leave with the child and the parents or caretakers must know that, if someone new will be picking up
the child, they must provide that information to K-Child. If there is any doubt about the identity of the person picking up the child, the volunteer must understand the importance of verifying that person’s identity before letting the child leave the facility or event.\footnote{35}

**Evaluation and Disciplinary Action**

Like paid employees, volunteers deserve periodic performance reviews. Most want feedback and will appreciate an opportunity to improve their skills and effectiveness. Evaluation is a multi-faceted process designed to improve the performance of both the volunteer and the agency. The organization should examine the volunteer’s work, note contributions and achievements, and make suggestions for changes and perhaps further training. The volunteer should appraise his own performance, set goals, and provide feedback on the strengths and weaknesses of the organization’s volunteer management program. Together, the parties should discuss how to strengthen the relationship between the volunteer and the organization and how to maximize the effectiveness of the volunteer. The organization should keep a written record of the evaluation session. If the organization is unhappy with the volunteer’s performance, it may be appropriate to take corrective action, which can occur following the evaluation. Corrective
action could include the requirement of additional training, re-assignment of a volunteer to a new position, suspension of the volunteer, or dismissal from volunteer service.\textsuperscript{36}

**Discrimination**

Title VII of the federal Civil Rights Act of 1991 prohibits employers of fifteen (15) employees or more, whether for-profit or nonprofit, from discriminating on the basis of race, color, religion, sex, or national origin.\textsuperscript{37} The Age Discrimination in Employment Act of 1967\textsuperscript{38} and the Americans with Disabilities Act of 1990\textsuperscript{39} prohibit discrimination based on age and disability. Although state civil rights laws vary, the Arkansas Civil Rights Act of 1993 also prohibits discrimination and applies to employers of nine (9) or more.\textsuperscript{40} Unless they fall under a specific exemption, all employers must comply with both federal and state employment laws. Churches and other religious entities have some leeway in that they may require their employees to adhere to their religious doctrines.\textsuperscript{41}

**Definition of Employee**

Under the federal Civil Rights Act of 1991, the term “employee” means an individual employed by an employer, excluding any person elected to public office or any person
chosen by an elected official to work for her, as a staff member or immediate adviser. The Arkansas Civil Rights Act of 1993 defines “employee” by stating that “employee does not include: (A) any individual employed by his or her parents, spouse, or child; (B) an individual participating in a specialized employment training program conducted by a nonprofit sheltered workshop or rehabilitation facility; or (C) an individual employed outside the State of Arkansas.” These definitions do not specifically address whether a volunteer would be considered an employee for purposes of a claim of employment discrimination. Nevertheless, a nonprofit should implement non-discriminatory practices and procedures even if it has few “employees” who may sue for discrimination. The most obvious reason is that it is the right thing to do; a more practical consideration is that the organization may eventually grow into civil rights law coverage.

One of the most effective ways to avoid discrimination and the appearance of discrimination is to make sure that the organization reflects the diversity of the community served. Directors, officers, volunteers and employees should reflect diversity of, for example, age, race, sex, religion, national origin and disability. Many groups also feel the need for other types of diversity, such as geographic and socio-economic.
Sexual Harassment

Any nonprofit developed enough to have written policies should address the issue of sexual harassment. Every nonprofit should have a written policy, make sure every member of the board, staff and volunteer corps is aware of it, and enforce it with a strict and even hand. Some organizations also need policies and procedures to prevent sexual harassment by clients. Nonprofits serving vulnerable populations such as children and youth, the elderly and people with disabilities should be particularly vigilant to prevent sexual harassment and abuse. An emerging organization like K-Child, which has no paid staff, may establish a grievance committee to address the concerns of volunteers.

Grievance Procedure

Like employees, volunteers should have access to appropriate grievance procedures. A volunteer should know who to go to with problems or concerns related to his volunteer service. If an organization finds it necessary to discipline or terminate a volunteer, there should be a procedure in place for the volunteer to appeal the decision. An emerging organization like K-Child, which has no paid staff, may establish a grievance committee to address volunteers’ concerns.
Dismissal and Resignation

Dismissal of a Volunteer

A nonprofit must be ready and willing to discharge a volunteer when necessary. All volunteers should be held to a high standard and expected to adhere to organizational rules and procedures. Volunteers should be advised of grounds for discharge, which may include theft, being under the influence of alcohol or drugs during volunteer service, mistreatment of clients or co-workers, inappropriate dress or language, and unsatisfactory performance. The organization should address its standards, reasons for dismissal, and dismissal procedures during volunteer orientation and in its volunteer handbook.

Except in an emergency, such as when a volunteer’s actions put a client at immediate risk, a volunteer’s supervisor should meet with her prior to dismissal to discuss the problem and possible remedies. An organization should make every attempt to be fair and to hear all sides of the story before discharging a volunteer. If discharge becomes necessary, it is important to document the problem, the steps that were taken to correct it, and the ultimate reasons for the discharge.
Resignation of a Volunteer

Volunteers may, of course, resign at any time. Since volunteers are vital to the functioning of most nonprofit organizations, they should be asked to give notice of their resignations as soon as possible. Job descriptions should include information about how much notice the organization requests for that particular job, depending on the needs of the organization.

Ideally, a nonprofit will conduct an exit interview with each departing volunteer. Of course, the organization wants to know why the volunteer is leaving. A final interview also provides an opportunity to thank the volunteer for his service and to ask for suggestions about improving the organization. If the volunteer is leaving with negative feelings, an exit interview may actually prevent the resignation, or at least give the organization an opportunity to address the problem. Volunteers and former volunteers are ambassadors from the organization to the community, so a nonprofit should do all that it can to see that volunteers leave on a positive note.
Endnotes

1 See http://www.managementhelp.org/staffing/outsourcing/volunteer/volunteer.htm#anchor140590 (follow “Recruitment Techniques” hyperlink) (This provides further information and advice on recruiting and managing volunteers).


3 Mark C. Lear, Just Perfect for Pedophiles? Charitable Organizations That Work with Children and Their Duty to Screen Volunteers, 76 Tex. L. Rev. 143, 181 (1997); see also Chapter IV for a more detailed description of the negligent hiring doctrine.

4 Id. at 147-48, 160-61.

5 Id. at 148.

6 http://www.archildrens.org/volunteer.


9 http://www.arkansas.gov (follow “Business” hyperlink; then follow “Professional Information” hyperlink).

10 Lear, supra note 3, at 168.


15 Ark. Code Ann. § 12-12-1605(c).


17 Ark. Code Ann. § 12-12-1606(a)(2). Criminal information requests performed online require the applicant’s first and last name, date of birth, race, and gender. See https://www.ark.org/criminal/index.php.


19 Ark. Code Ann. § 12-12-1607(b) (Supp. 2007).


23 http://www.acic.org/soff/index.php. The sex offender risk scale ranges from 1 to 4, with “1” being the lowest risk.

24 http://www.backgroundferret.com/free_background_check_resources.htm#Sexual%20Offender%20Registry

25 http://www.nsopr.gov. A criminal offense against a minor refers to the following range of offenses: kidnapping/false imprisonment of a minor (except by a parent), criminal sexual conduct toward a minor, solicitation of a minor to engage in sexual conduct, use of a minor in a sexual performance, solicitation of a minor to practice prostitution, any conduct that by its nature is a sexual offense against a minor, production or distribution of child pornography, or an attempt to commit any of these offenses. 42 U.S.C. § 14071(a)(3)(A) (Supp. 2005). A “sexually violent offense” refers to aggravated sexual abuse or sexual abuse, or an offense that involves engaging in physical contact with a minor.

Legal Guide for Arkansas Nonprofit and Volunteer Organizations

26 Lear, supra note 3, at 178.
27 HERMAN ET AL., supra note 2, at 158.
28 HERMAN ET AL., supra note 2, at 199.
29 Id. at 201.
30 Id. at 201-02.
31 See http://www.casanet.org/program-management/volunteer-manage/sample-manage.htm (follow “Volunteer Training and Development” hyperlink) (providing further information and suggestions on training employees).
32 HERMAN ET AL., supra note 2, at 202.
34 Id. at 202-203.
35 Id. at 202.
38 29 U.S.C. 621 et seq.
CHAPTER VI

Risk Management

K-Child’s Directors Consider Ways to Reduce Risks

Kim’s presentation on personnel issues in volunteer management was received with great enthusiasm. “This is a lot to digest,” admitted Zoey, “but this information is going to help me manage employees in my business. I didn’t realize how much I didn’t know about managing people.” Tim nodded in agreement.

“And, we’re also preparing for the day when we hire staff for K-Child,” said Claire.

“Now that we’re getting a handle on how to minimize the risks associated with volunteers,” noted Henry, “I’d like to see us step back and look at the bigger picture. What are the other risks K-Child faces and how can we best protect the organization?”

“I see where you’re going,” agreed Claire. “Some combination of prevention and insurance, I would think. Let’s set aside some money in our budget and hire Sandy to prepare a presentation on risk management.” The resolution passed unanimously.

After the meeting, Claire called Sandy, who agreed to make a presentation at the next board meeting without charge. To help focus her presentation, she asked that each board member email questions and concerns to her before the meeting. Sandy also asked Claire to copy and distribute some simple printed materials on risk management so that board members would be prepared to discuss the subject.
Introduction

Like any individual or organization, a nonprofit entity like K-Child is subject to various kinds of risks. Internal risks include potential loss of the nonprofit’s property through theft, flood or fire. Other areas of exposure, such as the risk of being sued, are external. The board of directors, in conjunction with the executive director, should discuss potential risks and establish policies and procedures to reduce the organization’s exposure.

Charitable and Governmental Immunity

While there are no Arkansas statutes that provide immunity for nonprofit organizations themselves, a nonprofit may be entitled to protection from tort liability under the common law doctrine of charitable immunity. This doctrine has a long standing history in Arkansas, although the vast majority of other states have completely abandoned it. The doctrine of charitable immunity protects “charities” from financial disaster by disallowing the execution of judgments against them due to the negligent acts of their agents. In other words, this doctrine is designed to protect a charity’s assets from being diminished because of an injury caused by the charity’s agent or employee.

As an example of how this doctrine works, assume K-Child
is entitled to charitable immunity. Suppose that K-Child has organized a kickball game for the children of the community. One of K-Child’s volunteers, Meredith, is driving a K-Child van, picking up those children needing a ride to the game. After stopping to pick up Erin at his house, Meredith places the van in reverse and begins backing out of the driveway. At the same time, Bobby, Erin’s younger brother, is wandering behind the van. Meredith, not seeing Bobby, hits him with the van and injures him. Bobby’s family sues K-Child. Even if Bobby’s family prevails in the suit, the family’s judgment against K-Child is meaningless because K-Child’s property is sheltered from that judgment. Thus, even though K-Child is found liable, K-Child does not suffer any penalty or punishment because of the protection provided by the charitable immunity doctrine.

Not all organizations that consider themselves nonprofits will qualify for immunity under this doctrine. The following factors often are used to determine eligibility for charitable immunity:

1. whether the organization’s charter limits it to charitable purposes,

2. whether the organization’s charter contains a “not for profit” limitation,

3. whether the organization’s goal is to break even,

4. whether the organization earned a profit,
5. whether any profit or surplus must be used for charitable purposes,

6. whether the organization depends on contributions and donations for its existence,

7. whether the organization provides its service free of charge to those unable to pay, and

8. whether the directors and officers receive compensation.⁶

While these factors are not exhaustive, the doctrine of charitable immunity is applied very narrowly.⁷ For example, a court decided that a juvenile rehabilitation camp housing juvenile offenders and funded by the Arkansas Department of Human Services, Division of Youth Services, could not benefit from the doctrine of charitable immunity.⁸ Several facts contributed to this conclusion: the camp’s charter did not limit it to charitable purposes; although it was tax exempt, there was no evidence that its goal was to break even; it was funded by the state, rather than being dependent upon donations, and had to return surplus funds to the state treasury instead of using them for charity; and its officers were compensated for their services.⁹

In another case, however, the Arkansas Supreme Court decided that a regional medical hospital was entitled to charitable immunity, despite the fact that it sought yearly profits, paid substantial salaries and bonuses to its CEO and CFO, and only
received six percent of its budget from donations. The court reasoned that a sizable hospital such as this could not be expected to operate in the same humble manner as other non-profits because of the complex nature of the industry.

Since Arkansas courts have been somewhat inconsistent in applying the doctrine of charitable immunity to various organizations utilizing volunteer workers, the best guidance for a current volunteer organization is to align oneself as closely as possible with the eight factors above. Ultimately, the totality of the circumstances (especially who is injured and how foreseeable the injury was) will dictate whether a nonprofit organization will fall under the protection of charitable immunity.

Arkansas nonprofits may not be able to count on charitable immunity in the future. The Arkansas Supreme Court has urged the General Assembly to consider abolishing the doctrine, as other state legislatures and courts have done.

**Direct Action Statute**

Arkansas has a statute, known as a “direct action statute,” which allows an injured person to directly sue an organization’s liability insurer, but only under certain circumstances. The direct action statute applies only if the organization that would be
the proper defendant enjoys charitable immunity, and therefore would be immune from any tort liability.\textsuperscript{14} Hence, the direct action statute provides recourse for a plaintiff that would otherwise have no real remedy against the organization itself. If a plaintiff sues under the direct action statute, he is limited to recovering the amount that would otherwise be paid under the terms of the insurance policy.\textsuperscript{15} This statute makes it clear that simply because an organization may be entitled to charitable immunity (and is therefore immune from tort liability), such an organization is \textit{not required} to carry liability insurance.\textsuperscript{16}

\textbf{Evaluating Liability}

Insurance policies designed for nonprofits can be tailored to include essentially any individual within the organization, including directors, officers, trustees, committee members, executive directors, faculty members, employees and volunteers. The nonprofit can also insure itself as an entity, typically by negotiating a separate agreement. Insurance companies generally insure a broader range of liabilities for nonprofits than for their for-profit counterparts, and nonprofits often are able to obtain coverage for typically uninsurable risks such as libel, slander, and plagiarism.

The first step in selecting insurance is to understand the
potential liability of the individuals involved in a nonprofit organization and potential liability of the organization itself. Liability issues for an unincorporated nonprofit association vary somewhat from those of an incorporated nonprofit.

**Directors and Officers**

The directors and officers of an incorporated nonprofit are subject to liability of three main types: (1) liability to the organization for a breach of fiduciary duty; (2) liability to third parties who have been injured by the organization; and (3) personal liability by statute for the organization’s violation of a state or federal law. Officers of an unincorporated nonprofit face similar liability; they are statutorily excused from vicarious liability arising out of the nonprofit’s actions but may be held personally liable for their behavior within the nonprofit.\(^{17}\)

Arkansas allows an incorporated nonprofit to indemnify a director against liability if the director conducted herself in good faith, reasonably believed that her conduct was not opposed to the corporation’s best interests, and had no reasonable cause to believe her conduct unlawful.\(^{18}\) That means that the nonprofit may pay the legal expenses of a director or officer provided that the expenses are not the result of dishonest or unreasonable conduct. Furthermore, a nonprofit must indemnify a director
when the director successfully defends himself against a suit in his personal capacity.\textsuperscript{19} However, such indemnification is not required if the organization’s articles of incorporation provide otherwise. On the other hand, indemnification is not allowed when a director is personally liable to the corporation or for receiving an improper personal benefit.\textsuperscript{20} These indemnification statutes cover officers as well as directors,\textsuperscript{21} although they almost certainly do not reach unincorporated and charitable trust nonprofits. Additionally, indemnification can sometimes be court-ordered.\textsuperscript{22}

\textit{Volunteers and Employees}

The federal Volunteer Protection Act of 1997 limits lawsuits against \textit{volunteers} serving through nonprofits and government agencies, when the volunteers are acting within the scope of their responsibilities, properly licensed, not willfully or recklessly causing harm, and not operating a vehicle requiring a license.\textsuperscript{23} See Chapter IV for more information on the Arkansas Volunteer Immunity Act and the Volunteer Protection Act of 1997. The difference between a volunteer and an employee appears to be that a volunteer acts without being compelled to act, and “without promise or expectation of compensation,” while an employee receives \textit{some} form of compensation and takes part in commercial activity.\textsuperscript{24}
The Organization Itself

A nonprofit, whether incorporated or unincorporated, seems to be subject to the same liabilities as any corporation or business association. While the doctrine of “charitable immunity” might be used to shield these organizations from liability, the doctrine has gradually fallen out of favor.25

Types of Insurance

Arkansas law Ark. Code Ann. § 4-33-857 allows an incorporated nonprofit to maintain insurance on behalf of directors, officers, employees, and “agents” of the corporation against liability “asserted against or incurred by him or her in that capacity or arising from his or her status as a director, officer, employee, or agent.”26 An “agent” is someone who is authorized to act for the organization, usually an officer, employee or independent contractor such as an accountant or attorney.

Liability insurance serves two main functions for nonprofit organizations: (1) it pays damages for which the nonprofit is found liable, and (2) it defends the organization in court when it is sued. This coverage is especially important for a nonprofit, which typically does not have the financial resources to support itself in legal proceedings; even if the nonprofit successfully
defends, it still may be forced into bankruptcy. There are several different types of insurance available to nonprofit organizations.

**Commercial General Liability**

Commercial General Liability is the most common type of liability insurance. This policy generally covers most claims arising from bodily injury, damage to property owned by others, and some types of personal injury. General liability coverage usually will cover the costs that accompany a lawsuit, as well as any settlement or damages that are awarded. While it is not a comprehensive policy, it can be combined with other coverage as part of a package, and typically excluded claims can be added in exchange for a higher premium.

**Workers’ Compensation**

Workers’ Compensation insurance is created by state statute and covers certain workers injured in job-related accidents. Insurance rates are based on a number of factors, including salaries, firm history, and risk of occupation. Workers’ compensation basically would shield the nonprofit against further liability to its employees. Under Arkansas law, every
“employer” must comply with workers’ compensation laws and provide workers’ compensation benefits to injured employees. An “employer” is any individual or organization that carries on any “employment.” “Employment” means every employment in Arkansas in which three (3) or more employees are regularly employed by the same employer in the course of business except “a person performing services for any nonprofit religious, charitable, or relief organization.” This suggests that Arkansas nonprofit organizations are exempt from liability under workers’ compensation law.

However, it may be wise for nonprofits to consider participating in workers’ compensation because the “exclusive remedy” doctrine applies to this type of coverage. This means that the worker is limited to receiving benefits under the organization’s workers’ compensation policy, and is likely to be precluded from pursuing a liability claim against the organization.

**Motor Vehicle**

If an employee or volunteer gets into an automobile accident while performing services for the nonprofit, both the organization and the individual may be liable. Individuals driving their own cars may be covered by their own policies. Nonprofits that own vehicles probably should purchase commercial auto insurance,
which normally applies only to employees but can be extended to volunteers for an additional charge.\textsuperscript{34}

\textit{Umbrella Liability}

Umbrella liability insurance is usually a supplementary policy purchased in addition to and above the ordinary primary liability coverage.\textsuperscript{35} This coverage typically overlays most major policies by increasing the limits of each liability, offers broader coverage by decreasing excluded claims, and provides first-dollar liability coverage in many areas of potential liability.\textsuperscript{36}

\textit{Professional Liability}

If a nonprofit performs “professional services” such as legal or medical, claims arising out of these services typically are not covered by commercial general liability insurance. As a result, separate professional liability insurance is needed to adequately protect against these risks.\textsuperscript{37}

\textit{Association Professional Liability or Directors’ and Officers’ Liability}

This type of policy goes by different names: Association Professional Liability, Directors’ and Officers’, or simply D & O. It is similar to regular professional liability insurance. D
& O, however, is structured in a more complex manner. The protected individuals are not necessarily “professionals” as much as they are fiduciaries of the organization.\textsuperscript{38} This type of insurance protects both the corporation from sizable losses it could experience because of indemnification statutes like the ones discussed above and directors and officers for losses against which the company does not or cannot indemnify them.\textsuperscript{39}

\textit{Property Insurance}

Property insurance covers repair or replacement costs caused by most risks to the building, improvements, and contents owned by the nonprofit.\textsuperscript{40}

\textit{Selection of Insurance}

In determining which insurance policy is the best fit for any given nonprofit organization, the organization must first analyze the specific level and types of risk that it faces. Factors to be considered include the probability of the risk’s occurrence, the extent of potential damage, and the involvement of outside parties.\textsuperscript{41} Once the organization has completed this self-evaluation, it must decide which insurance package best addresses its particular risks and needs; for example, if the nonprofit provides substantial professional services, it will likely be wise to
acquire professional liability insurance. In the same vein, if the nonprofit will be dealing with risks that could impose astronomical damages, then umbrella insurance would seem necessary.

Ultimately, most nonprofits mix and match these policies in order to sufficiently guard against risk; however, as a practical matter there will always be some level of risk left unaddressed. The job of the nonprofit’s decision-makers is to determine which risks are prudent to cover and which are best left internalized.

Reducing Risk

A nonprofit board of directors sets policies to guide the organization. Comprehensive written policies reduce risk by establishing expectations and standardizing practices within the organization. Any nonprofit with paid staff should have written personnel policies; likewise, an organization should develop policies covering the recruitment, supervision and activities of its volunteers.

Although it is usually the prerogative of the board to review and approve policies, staff members and volunteers can be helpful in developing and reviewing policies related to their duties. For example, an organization’s bookkeeper or accountant will certainly have something to contribute to the development of financial policies.
To be effective, policies must be: (1) up-to-date, (2) well written, and (3) followed. To ensure that policies are up-to-date, they should be reviewed regularly.

Litigation Preparedness

It is still fairly uncommon for a nonprofit organization to be sued; however, it is a possibility that nonprofits should not ignore. A nonprofit organization is more likely to be sued as the organization grows, increases its staff membership, purchases more buildings, and negotiates complex agreements. No matter how large or small, every organization can take steps to be better prepared for litigation. For example, every organization should be careful to document all decisions made by the board, and all incidents with employees, volunteers, and clients. Furthermore, organizations should create and follow comprehensive procedures for dealing with incidents, such as injuries suffered by a client, or complaints made by an employee. Lastly, an organization should have a relationship with an attorney that it trusts.

“Being on the K-Child board has been a real education,” said Claire to Sandy. The two were back at Dipper Diner, this time for its famous plate lunch. “I never imagined how much is involved in starting and running a nonprofit organization.”
It’s really worth the effort, though. Did you see the latest report from the Department of Education? The kids at Little Dipper Elementary have made dramatic improvements in overall fitness. And, they’re having a ball!”

Endnotes

1 See Ouachita Wilderness Institute, Inc. v. Mergen, 329 Ark. 405, 418, 947 S.W.2d 780, 787 (1997) (citing Masterson v. Stambuch, 321 Ark. 391, 902 S.W.2d 803 (1995)).
3 Mark C. Lear, Just Perfect for Pedophiles? Charitable Organizations That Work with Children and Their Duty to Screen Volunteers, 76 TEX. L. REV. 143, 169 (1997) (“[S]uch general charitable immunity is now observed by only one state, [Arkansas,] and just six others provide partial immunity.”).
5 Id.
7 See id.
8 Mergen, 329 Ark. at 418-19, 947 S.W.2d at 787.
9 Id.
10 Jefferson Hosp., 337 Ark. at 214, 987 S.W.2d at 714.
11 Id.; see also Clark, supra note 2, at 145.
17 Ark. Code Ann. § 2-48-506(b) & (c); see also Phillip Carroll, Uniform Laws in Arkansas, 52 Ark. L. REV. 313 (1999).
20 Ark. Code Ann. § 4-33-851(c); see also Ark. Code Ann. § 4-33-855.
28 Id.
33 Herman et al., supra note 27, at 111.
34 Insurance Basics, supra note 27.
36 Id.
37 Insurance Basics, supra note 27.
38 Olson & Hatch, § 12:1.
39 Id.
41 Victor Futter et al., Nonprofit Governance and Management 440 (2d ed. 2002).
Appendices

A. Selected Resources
B. Sample Conflict of Interest Policy
C. Outline of Subjects Typically Covered in Bylaws
D. Arkansas Statutes of Special Interest to Nonprofits

The Arkansas Nonprofit Corporation Act of 1963
The Arkansas Nonprofit Corporation Act of 1999
Act 569 of 2007
Solicitation of Contributions and Registration of Fundraisers
The State and Local Government Volunteers Act
The Arkansas Civil Rights Act of 1993
The Fair Labor Standards Act and Arkansas Wage and Hour Law
Appendix A

Selected Resources

Accountants for the Public Interest (API)

Accountants for the Public Interest (API) is a national nonprofit organization whose mission is “to encourage accountants to volunteer their time and expertise to nonprofits, small businesses and individuals who need, but cannot afford, professional accounting services.” To find out more about API’s program and services, visit its website at www.geocities.com/api_woods/api/apihome.htm.

API offers the following excellent low-cost publications for nonprofits.

API’s Complete Guide to Accounting Procedures for Nonprofit Organizations
This 96 page book is new in 2002. In an easy-to-read format, this 96 page book references the latest accounting pronouncements pertinent to non-profit organizations, explains the principles of non-profit accounting and key management concerns of non-profits, and illustrates how they differ in many important ways from for-profit businesses. It includes a glossary of accounting terms and numerous examples of various IRS forms. $28 each, postpaid.

API’s Complete Guide to the Nonprofit Audit
This 88 page book, written in layman’s terms, is a must for non-profits who want to train their staff and volunteers on how to prepare for an audit. Accounting information processing is described, and a glossary defines key accounting terms. There are sections on the recording and processing transactions, basic concepts of internal controls and how to implement
them, and on how to select an auditor and negotiate the audit contract. $28 each, postpaid.

What a Difference Knowledge Makes: A Guide to Intermediate Sanctions for Non-Profit Organizations and their Leaders
In January, 2002 the IRS finalized its Intermediate Sanctions regulations for non-profits and began enforcing them. This important book describes Intermediate Sanctions, a bill signed into law in 1999 as part of the Taxpayer’s Bill of Rights II, and which penalizes insiders who receive an excess benefit from their involvement with non-profit organizations. The guide defines excess benefits and gives real life examples of how non-profits and their leaders can run afoul of the law. $28 each, postpaid.

What a Difference Understanding Makes: Guides to Non-Profit Management
This series of five easy-to-read and understand booklets are excellent resources for managers of non-profit organizations. The booklets, which sell for $8 each or $35 for all five, postpaid, are:

Tracking Special Monies
Selecting Computer Software
Filing Non-Profit Tax Forms
Making Public Disclosures
Classifying 501(c) Nonprofits

API Account
Accountants for the Public Interest’s quarterly newsletter, distributed to 3,500 readers internationally, describes the services and activities of API’s affiliates in the United States and Japan. $40 annually.
Arkansas Coalition for Excellence

Arkansas Coalition for Excellence (ACE) is Arkansas’s nonprofit for nonprofits. It is a membership organization made up of nonprofits, individuals, foundations and businesses united by their commitment to nonprofit success in Arkansas. ACE is dedicated to elevating capacity and promoting the success of Arkansas’ nonprofit sector. Visit the ACE website at http://acenonprofit.org.

Arkansas Department of Human Services – Division of Volunteerism (DOV)

Since 1974, the Division of Volunteerism has offered training, technical assistance and information at no cost to Arkansans as well as inquirers across the country and around the world. It is the oldest state office of volunteerism in the United States. DOV provides training and technical assistance in board development, risk management, applying for nonprofit tax exempt status, grant seeking, volunteer management, and numerous other areas. DOV also provides certificates, Governor’s letters, and recognition bookmarks to volunteer organizations. It is a co-sponsor of the annual Community Service Awards and Arkansas Volunteer Community of the Year Awards. Funding for AmeriCorps national service programs is available from the Arkansas Service Commission, which is located in the Division of Volunteerism. More information is available at the DOV web site: http://www.arkansas.gov/dhs/adov/.

Independent Sector

Internal Revenue Service On-Line Resources

General Information for Charities

The IRS website page for charities, found at www.irs.gov/charities/index.html, offers various resources for tax-exempt organizations, including forms, news and answers to frequently asked questions.

Workshop for Exempt Organizations: Tax Basics for 501 (c)(3)s

The IRS offers a free interactive workshop designed to familiarize users with tax compliance issues of interest to tax exempt organizations. The workshop, available at www.stayexempt.org, consists of five modules:

- Tax-Exempt Status – How can you keep your 501(c)(3) exempt?
- Unrelated Business Income – Does your organization generate taxable income?
- Employment Issues – How should you treat your workers for tax purposes?
- Form 990 – Would you like to file an error-free return?
- Required Disclosures – To whom do you have to show your records?

Nonprofit Risk Management Center

The Nonprofit Risk Management Center is an excellent resource, providing free technical assistance on a wide range of topics related to legal risks inherent in nonprofit governance and management. The Center’s website and reasonably-priced
publications are easy to understand and packed with reliable, practical advice. Visit the Center’s website at www.nonprofitrisk.org or call 202-785-3891 for more information.

University of Arkansas

The University of Arkansas offers a website designed to be used as a free tool for nonprofit organizations and individuals interested in starting nonprofits. Visit the website at www.uacted.uark.edu/legalesource/index.html.

University of Arkansas at Little Rock

The University of Arkansas at Little Rock (UALR) has several programs of special interest to nonprofits, including the Center for Nonprofit Organizations, which seeks to improve the capacity of the nonprofit sector through an interdisciplinary application of community and University resources. UALR also offers a graduate certificate in Nonprofit Management. For more information, visit http://ualr.edu/iog/nonprofitcenter or contact Kim Evans at khevans@ualr.edu or 501-569-8026.
Appendix B

IRS Sample Conflict of Interest Policy

Note: Items marked for hospitals that complete Schedule C have not been included in this version. For more information, see the IRS website, www.irs.gov.

Article I
Purpose

The purpose of the conflict of interest policy is to protect this tax-exempt organization’s (Organization) interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Organization or might result in a possible excess benefit transaction. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to nonprofit and charitable organizations.

Article II
Definitions

1. Interested Person
Any director, principal officer, or member of a committee with governing board delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

2. Financial Interest
A person has a financial interest if the person has, directly or indirectly, through business, investment, or family:

   a. An ownership or investment interest in any entity with which the Organization has a transaction or arrangement,
b. A compensation arrangement with the Organization or with any entity or individual with which the Organization has a transaction or arrangement, or
c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Organization is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

**Article III Procedures**

1. **Duty to Disclose**
   In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement.

2. **Determining Whether a Conflict of Interest Exists**
   After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the governing board or committee meeting while the determination of a conflict of interest is discussed.
and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

   a. An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.

   b. The chairperson of the governing board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.

   c. After exercising due diligence, the governing board or committee shall determine whether the Organization can obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.

   d. If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization’s best interest, for its own benefit, and whether it is fair and reasonable. In conformity with the above determination
it shall make its decision as to whether to enter into the transaction or arrangement.

4. Violations of the Conflicts of Interest Policy

a. If the governing board or committee has reasonable cause to believe a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.

b. If, after hearing the member’s response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

Article IV
Records of Proceedings

The minutes of the governing board and all committees with board delegated powers shall contain:

a. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the governing board’s or committee’s decision as to whether a conflict of interest in fact existed.
b. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.

Article V
Compensation

a. A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member’s compensation.

b. A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member’s compensation.

c. No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.

Article VI
Annual Statements

Each director, principal officer and member of a committee
with governing board delegated powers shall annually sign a statement which affirms such person:

a. Has received a copy of the conflicts of interest policy,

b. Has read and understands the policy,

c. Has agreed to comply with the policy, and

d. Understands the Organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes

**Article VII**

**Periodic Reviews**

To ensure the Organization operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

a. Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm’s length bargaining.

b. Whether partnerships, joint ventures, and arrangements with management organizations conform to the Organization’s written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in inurement,
impermissible private benefit or in an excess benefit transaction.

**Article VIII**
**Use of Outside Experts**

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use shall not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.
Appendix C

Outline of Subjects Typically Covered in Bylaws

I. Name of organization

II. Statement of mission or purpose

III. Board of directors
   A. Number of directors
   B. Length of terms
   C. Qualifications
   D. Nominations and elections
   E. Meetings
   F. Committees
   G. Removal
   H. Procedures for filling vacancies

IV. Officers
   A. Titles
   B. Duties
   C. Nominations and elections
   D. Removal
   E. Procedures for filling vacancies

V. Membership (if the organization has members)
   A. Procedure for becoming a member
   B. Member records
   C. Meetings
D. Voting procedures

VI. Rules of order

VII. Fiscal year

VIII. Indemnification of directors, officers, volunteers, staff

IX. Procedures for amending the bylaws

X. Procedures for the dissolution of the corporation
Appendix D
Arkansas Statutes of Special Interest to Nonprofits

Introduction

Like their for-profit counterparts, nonprofit organizations are subject to many rules and regulations, including statutes enacted by state legislatures and Congress. The following summary includes some of the Arkansas statutes that affect nonprofit organizations. In consulting this summary, be aware that it does not attempt to give legal advice on the particular situation of your group and it does not include all of the laws affecting nonprofit organizations. Moreover, the law is constantly changing, so it is essential to consult the latest version of these statutes before relying on them. The Arkansas Code is available free online at www.arkleg.state.ar.us/data/ar_code.asp.

The Arkansas Nonprofit Corporation Act of 1963

If an Arkansas nonprofit organization was incorporated before 1994, it is governed by the Arkansas Nonprofit Corporation Act of 1963, unless it elects to operate under the Arkansas Nonprofit Corporation Act of 1993. For information about the 1993 Act and the election, see the following section.

The 1963 Act offers general legal guidance on the organization, operation, and dissolution of Arkansas nonprofits. Highlights include the following:

♦ A nonprofit corporation must have at least three directors;²

♦ Terms of office for directors may not be more than six years;³
A nonprofit may have members or may have no members, as provided in the articles of incorporation;\(^4\)

A nonprofit corporation may not issue shares of stock or pay dividends;\(^5\)

A nonprofit may not loan money to its directors or officers;\(^6\)

A nonprofit must keep correct and complete books and records of its accounts, meetings, and members;\(^7\)

If a nonprofit corporation shuts down, the board of directors must first pay off debt, then distribute any remaining assets for nonprofit purposes;\(^8\)

See Chapter 1 for more information about incorporating as a nonprofit. Most aspects of nonprofit life are not covered in the Nonprofit Corporation Act, so an organization’s articles of incorporation and bylaws are very important.

**The Arkansas Nonprofit Corporation Act of 1993**


**Highlights of the 1993 Act**

The 1993 Act is more comprehensive than the older law and was intended to fill in some of the gaps that became apparent as the State’s nonprofit sector grew and developed. The Act begins
by describing the process for incorporating as a nonprofit by filing articles of incorporation with the Arkansas Secretary of State. 10 See Chapter 1 for more information about incorporating as a nonprofit. Other provisions cover holding and conducting meetings of members and directors, 11 authority for action without meetings, 12 requirements for voting, 13 and detailed guidance as to what constitutes proper notice of meetings. 14 The 1993 Act also provides for operation of an organization in an emergency, defined as a situation in which the corporation’s directors cannot readily be assembled because of a catastrophic event. 15 Many sections of the 1993 Act are intended to fill in the gaps in a nonprofit’s articles of incorporation or bylaws and can be superseded by those documents. For example, the section on “officers” reads: “Unless otherwise provided in the articles or bylaws, a corporation shall have a president, a secretary, a treasurer and such other officers as are appointed by the board.” 16 Similarly, a quorum of a board of directors consists of a majority of the directors in office immediately before a meeting begins, except as otherwise provided in the statute, the articles of incorporation, or the bylaws. 17

**Benefits of election**

The principle benefit of election is that the 1993 Act provides more guidance for nonprofit organizations than did the old law. For a discussion of the advantages of electing to be subject to the 1993 Act, see *The Nonprofit Corporation Act of 1993: Considering the Election to Apply the New Law to Old Corporations*, a 1994 article by James Edward Harris published in the University of Arkansas at Little Rock Law Journal. 18

**How to elect**

To make the election, the organization must amend its articles of incorporation to indicate that it will be governed
under the new law. The amendment must also indicate whether the nonprofit is a public benefit, mutual benefit or religious corporation. The amendment must be approved by a majority of the members of the organization or, if there are no members, by a majority of the directors. The amendment must then be filed with the Secretary of State. The current fee for filing an amendment to articles of incorporation is $50. Once made, the election is irrevocable.

**Act 569 of 2007**

Act 569 of 2007 requires nonprofit corporations to file an annual report with the Arkansas Secretary of State. The report must include the name of the corporation, its jurisdiction, the name and address of its registered agent, the address of its principal office, the names of its principal officers and the names and addresses of its directors. The report will be due by August 1, starting with the report for the 2007 reporting year, which was due August 1, 2008.

**Statutes Regulating Solicitation of Contributions and Registration of Fundraisers**

The Arkansas Attorney General oversees charitable solicitation in Arkansas, including registration of charities that request donations from the public and registration of paid fundraisers. The purpose of registration is to prevent fraudulent fundraising activities and help people make educated choices about giving. The Attorney General maintains a user-friendly website at [www.ag.state.ar.us](http://www.ag.state.ar.us) and can be contacted at 501-682-2007 or 1-800-482-8982. Following is a brief summary of charitable registration requirements.
Definitions

A “charitable organization” is any person who holds himself or herself out to be established for any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or other charitable purpose. A “charitable organization” may also be any person established for the benefit of law enforcement personnel, fire fighters, or other persons protecting public safety. Finally, any person who employs charitable appeal in any way for solicitation or an appeal which tends to suggest a charitable purpose for such solicitation is considered a “charitable organization.”

A “charitable purpose” is any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or general charitable objective.

A “paid solicitor” is a person who: (i) for compensation, performs for a charitable organization any service in which contributions are solicited by the person or by another person he or she employs, procures, or engages to solicit for compensation; or (ii) at any time has custody or control of contributions. A bona fide permanent salaried officer or employee of a charitable organization is not a “paid solicitor” under this statute.

A “solicitation” is each request, either directly or indirectly, for a contribution on the plea or representation that the contribution will be used for a charitable purpose. A “solicitation” occurs when the request is made, at the place the request is received, whether or not the person making the request actually receives any contribution.

A “person” may be an individual, corporation, limited liability corporation, association, partnership, foundation, or other entity.
**Registration Requirements**

Before a charitable organization may solicit contributions from persons in Arkansas, that organization must: (i) be registered; provide certain information regarding the solicitation on forms provided by the Attorney General of Arkansas; and file the information with the Attorney General. The information on those forms is available to the general public in most instances.

The information in the forms must be sworn to and must at a minimum include: (i) the identity and address of the charitable organization doing the solicitation; (ii) the purpose of the solicitation; (iii) who will have custody of and who will distribute the contributions; (iv) the timeframe of the promotion; (v) a description of the methods of solicitation; (vi) whether voluntary unpaid solicitors, paid solicitors, or both will be conducting the solicitation; (vii) if there are paid solicitors, their name and address, basis of payment, nature of arrangement, and copy of contract for services; and finally (viii) a copy of the IRS tax-exempt status form.

**Financial Reporting**

On or before May 15 of each year, a charitable organization must file with the Attorney General a copy of all tax or information returns. This filing must include all schedules and amendments submitted to the IRS for the previous reporting year, except any schedules of the organization’s contributors. A charitable organization that maintains its books by fiscal year instead of calendar year, upon application to the Attorney General, may file the returns within six (6) months after the close of its fiscal year.

If a charitable organization has gross revenues greater than $500,000 (not including grants or fees from government
agencies) in any fiscal year, it must submit in addition to tax records an audit report of a certified public accountant.\textsuperscript{49}

If a charity is required to register with the Attorney General but not required to file returns with the IRS, it should submit an annual report in forms provided by the Attorney General.\textsuperscript{50}

A charitable organization may receive an extension of six months for the filing of records and other reports upon the Attorney General’s approval of a written request and showing of good cause.\textsuperscript{51}

A charitable organization must keep a full and true record, which is open to inspection and copying at all times by the Attorney General. By keeping a full and true record, a charitable organization is able to provide the information required by this statute.\textsuperscript{52} Donor lists obtained in accordance with this statute are not subject to disclosure without a court order, but donor lists and other records may be disclosed to other law enforcement agencies.\textsuperscript{53} An organization must retain its records for at least three years after the end of the fiscal year to which they relate.\textsuperscript{54}

**Exemptions from Registration and/or Financial Reporting**

A chapter, branch, or affiliate in Arkansas of a registered parent organization is not required to register as long as the parent organization files a consolidated financial report or tax information form for itself \textit{and} the chapter, branch, or affiliate.\textsuperscript{55}

The following organizations are exempt from this statute’s requirements for registration, financial reporting, and contract reporting, provided that each organization submits any information required by the Attorney General to substantiate its exemption:
(i) Religious organizations, i.e., any good faith, duly constituted religious entity if it satisfies each of the following criteria: (a) it is tax-exempt under the Internal Revenue Code, and (b) no part of its net income goes to the direct benefit of any individual;\textsuperscript{56}

(ii) Educational institutions, i.e., any parent-teacher association or educational institution whose curricula in whole or in part are registered or approved by any state or the U.S. directly or are accredited by an accrediting body;\textsuperscript{57}

(iii) Political candidates and organizations, i.e., any candidate for national, state, or local office or a political party or committee required to file information with the Federal Election Commission or state election commission or an equivalent agency;\textsuperscript{58}

(iv) Governmental organizations, i.e., any department, branch or other instrument of the federal, state, or local governments;\textsuperscript{59}

(v) Nonprofit hospitals, i.e., any nonprofit hospital licensed by Arkansas or in any other state;\textsuperscript{60}

(vi) Any charitable organization that does not intend to solicit and receive, and does not actually receive, contributions exceeding $25,000 in a calendar year: (a) if all its functions (including fundraising) are carried on by unpaid persons, and
(b) provided that no part of its assets or income goes to any officer or member;\textsuperscript{61} and

(vii) Any person who solicits solely for the benefit of the organizations described above.\textsuperscript{62}

**Prohibited Practices of Paid Solicitors**

A person may not act as a paid solicitor unless he or she first registers with the Attorney General.\textsuperscript{63} In order for a paid solicitor to represent that any contributions will be given or donated to any charitable organization, the organization must first consent in writing to the use of its name before the solicitation occurs.\textsuperscript{64} A paid solicitor may not represent that tickets to an event are to be donated for someone else’s use, unless a charitable organization first states in writing that it will accept donated tickets and specifies the number of tickets it will accept.\textsuperscript{65} The solicitor may not solicit more contributions for donated tickets than number of ticket commitments from the organization.\textsuperscript{66} Finally, a paid solicitor may not solicit contributions from citizens or entities in Arkansas on behalf of an unregistered charitable organization.\textsuperscript{67}

**Arkansas organizations that solicit in other states**

Most states, like Arkansas, have statutes that require charitable organizations to register before soliciting contributions within their borders and to submit annual reports of fundraising activities. These statutes serve two purposes: to inform people making decisions about charitable giving and to protect the public from charity-related fraud. Since registration statutes tend to define “solicitation” broadly, a charity may be required to register in a particular state even if it does not have a physical presence there.
Standardized Registration

States vary widely in their rules, expectations and enforcement practices, so registration and reporting can be a significant burden for a charity soliciting in more than one state. In response to this problem, the National Association of Attorneys General (NAAG) and the National Association of State Charities Officials (NASCO) developed a standardized registration process for nonprofit organizations. Most states accept the standard registration. The necessary form, the Unified Registration Form, is available at www.nasconet.org. Keep in mind that standardized registration does not avoid the need to submit annual reports on a state-by-state basis.

Website Solicitation

The growing practice of web solicitation of donations has created another problem – determining where internet activity, which obviously reaches citizens of all states, requires a charity to register. Since there is no uniform federal law addressing this issue, charities are faced with a hodgepodge of state statutes and regulations and little cohesive guidance.

In an attempt to establish guidelines for charities that solicit funds via the web, the NAAG and the NASCO issued the “Charleston Principles.” The general approach of the Charleston Principles is that an out-of-state charity with a website should not be required to register simply because it maintains a passive web presence. The Charleston Principles are not law and are not binding in any state. Nevertheless, they enjoy broad support from state attorneys general and apparently have not been repudiated by any state.

In summary, the Charleston Principles suggest that a charity should be required to register in each state where:
• it has its principal place of business; or

• its non-internet activities alone would be sufficient to require registration; or

• it solicits contributions though an interactive website and

  - specifically targets people located in that state for solicitation, or

  - receives ongoing or substantial contributions through its website from people located in the state; or

• it solicits contributions through a non-interactive website, but either specifically invites further offline activity to make a contribution or establishes other contacts with the state, such as sending email messages or other communications promoting the website.

In the interest of public disclosure, the Charleston Principles also contain a statement encouraging charities to post their current Unified Registration Statement, their last three IRS Forms 990, and their complete IRS Form 1023 or 1024 application and resulting determination letter on their websites.

The State and Local Government Volunteers Act

The State and Local Government Volunteers Act (the “SLGVA”) is designed to make sure that the people of Arkansas derive the greatest possible benefit from volunteers in state and local agencies. The SLGVA authorizes all agencies, departments, institutions, and divisions of state government to develop volunteer programs to accept the services of volunteers and donors. The SLGVA also exempts volunteers in state and
local agencies from all state employment laws. The SLGVA sets forth the rules covering reimbursement of volunteers for meals, lodging, and transportation expenses, and it provides the circumstances under which meals and lodging may be furnished to volunteers at no charge.

**The Arkansas Civil Rights Act of 1993**

The Arkansas Civil Rights Act prohibits any employer with nine or more employees in Arkansas from discriminating against any person on the basis of race, religion, national origin, gender, or disability. A victim of discrimination may sue for reinstatement, back pay, compensatory and punitive damages, attorney fees and court costs.

**The Fair Labor Standards Act and Arkansas Wage and Hour Law**

The Fair Labor Standards Act (FLSA) of 1938 establishes requirements for employers that aim to ensure employees’ minimum standard of living and general health and well-being. Those requirements regulate the minimum wage, overtime pay, equal pay, and child labor for employees covered by the act. Whether an employer or an organization is covered by the FLSA’s scope will depend largely on whether the employer deals with commerce or is a public agency. Most employers and employees are covered.

**Persons Protected by the FLSA**

If an individual is an employee, generally he will be protected by the FLSA if he is engaged in commerce or in the production of goods for commerce or is employed by an enterprise so engaged. Commerce includes trade, commerce, transportation, transmission, or communication among or between the states. This definition covers many activities, but
it is not all-inclusive. An enterprise is engaged in commerce or in the production of goods for commerce if the enterprise has employees engaged in such activities, or has employees handling, selling, or working on goods or materials that have been moved in or produced for commerce by any person and whose annual gross volume of sales made or business done is not less than $500,000. An enterprise is also engaged in commerce if it is engaged in the care of the sick, the aged, or the mentally ill or defective who reside on the premises of such institution, a school for mentally or physically handicapped or gifted children, a preschool, elementary or secondary school or an institution of higher education (regardless of whether or not such hospital, institution, or school is public or private or operated for profit or not for profit) . . . or is an activity of a public agency. If an organization is determined to be an enterprise engaged in commerce, the enterprise will have to comply with the wage standards of the FLSA.

**Persons Exempt from FLSA Coverage**

Ordinarily the FLSA will not cover someone who claims to be a volunteer. “An individual who, ‘without promise or expectation of compensation, but solely for his personal purpose or pleasure, worked in activities carried on by other persons either for their pleasure or profit,’ is outside the sweep of the [FLSA].” This is usually the case with volunteers, students, or trainees. However, in determining whether someone is an employee, courts also use the economic reality test. The focal point of the test is whether the individual is economically dependent on the business to which the individual renders services.

The largest exemption to the definition of employee under the FLSA is for volunteers for public agencies. Someone is a volunteer for a public agency if (1) “the individual receives no compensation or is paid expenses, reasonable benefits, or a nominal fee to perform the services for which the individual
volunteered; and (2) such services are not the same type of services which the individual is employed to perform for such public agency.”  

The definition of employee also does not include individuals who volunteer “solely for humanitarian purposes to private non-profit food banks and who receive from the food banks groceries.”

A volunteer has been defined as “[a]n individual who performs hours of service for a public agency for civic, charitable, or humanitarian reasons, without promise, expectation or receipt of compensation for services rendered.” An individual will only be a volunteer if his services are given freely without pressure or coercion from an employer. While a person’s motivation to volunteer will be a factor in determining whether one intended to be a volunteer, that motivation does not have to always be altruistic.

When looking at whether someone falls under the definition of a volunteer, the court will apply that definition in a common-sense manner, taking into account the “totality of the circumstances surrounding the relationship between the person providing services and the entity for which the services are provided, in light of the goals of the FLSA.” The main factor will be whether both parties, using common-sense, understand that the person performing services is doing so on a voluntary basis. When analyzing whether the parties understood the services to be, a court will look at the parties’ “statements, attitudes, and outward manifestations of their motivations, as well as any other available objective indicia that indicate[s] whether a volunteer or employment relationship was contemplated by the parties.” The person seeking compensation under the FLSA bears the initial burden of proving an employer-employee relationship existed. Once the burden is met, the employer must prove an exemption or exception under the act.
“Volunteers may be paid expenses, reasonable benefits, a nominal fee, or any combination thereof, for their service without losing their status as volunteers.” A short list of some of the things allowed include uniforms, out of pocket costs incurred incidental to providing volunteer services, cost of meals, cost of transportation, tuition, books, supplies, materials, group insurance, and pension plans. Whether compensation for expenses, benefits, or fees would result in an individual losing her volunteer status will be determined by “examining the total amount of payments made in the context of the economic realities of the particular situation.”

An employee cannot be considered a volunteer for a public agency if his volunteer services are the same type of services which the individual is employed to perform for the same public agency he works for. A determination on whether two agencies of the same state or local government constitute the same public agency will be determined on a case-by-case basis. The phrase, “the same type of services” means “similar or identical services.” Some examples of services that are not considered the same type of services for volunteer purposes include a city police officer volunteering as a referee in a basketball game sponsored by the city and an office employee of a city hospital spending off duty hours with disabled persons as an act of charity. If two or more agencies of a state or local government work together for mutual aid, volunteer status will not be taken away.

**Arkansas Wage and Hour Law**

If an individual or an enterprise does not fall under the jurisdiction of the FLSA, state wage and hour regulations come into play. The Arkansas definition of employer does not include employers covered by the FLSA and those who employ less than four employees in a workweek. An employee generally includes any individual employed, but there are many exceptions, including “[a]ny individual engaged in the
activities of any educational charitable, religious, or nonprofit organization where the employer-employee relationship does
not in fact exist or where the services are rendered to the
organizations gratuitously.”

There is little case law interpreting Arkansas wage and hour statutes because most employees fall
under the coverage of the FLSA. Because the state and federal requirements are similar, the case law interpreting the FLSA
provides some guidance in interpreting the Arkansas statutes.

Endnotes

2 Ark. Code Ann. § 4-28-211(b) (West 2004).
3 Ark. Code Ann. § 4-28-211(c) (West 2004).
36 Id.
47 Id.
50 Ark. Code Ann. § 4-28-403(c).
52 Ark. Code Ann. § 4-28-403(e)(1)-(2).
60 Ark. Code Ann. § 4-28-404(5).
68 www.naag.org
69 www.nasconet.org
76 Id.
77 Id.; Zorich v. Long Beach Fire Dep’t & Ambulance Service, Inc., 118 F.3d 682, 686 (9th Cir. 1997) (finding that an individual is covered by the FLSA if they are an employee who is engaged in commerce or works for an enterprise who is engaged in commerce).
78 29 U.S.C. § 203. The term produced “means produced, manufactured, mined, handled, or in any other manner worked on in any State; and for the purposes of this chapter an employee shall be deemed to have been engaged in the production of goods if such employee was employed in producing, manufacturing, mining, handling, transporting, or in any other manner working on such goods, or in any closely related process or occupation directly essential to the production thereof, in any State.” Id.

79 See Stevens v. Welcome Wagon Int’l, Inc., 261 F.Supp. 227, 229 (E.D. Pa. 1966) (finding that an employee who contacted local families to publicize local sponsors’ businesses was not engaged in commerce nor in the production of goods for commerce); see also Johnston v. Spacefone Corp., 706 F.2d 1178, 1182 (11th Cir. 1983) (stating that because congress did not include employees “who merely ‘affect’ commerce . . .” Congress did not extend the FLSA’s coverage to the constitutional maximum and left local business regulation to the states).


81 Id.


84 Id. at 299-300.

85 Id. at 301.

86 Id. at 301. In this case individuals were mainly rehabilitated drug addicts and criminals claiming to volunteer their services to a religious organization. Many testified that they did not want compensation for their work. However, because the FLSA defines wages to include board, food, lodging, and similar benefits (29 U.S.C. § 203(m)), the fact that the individuals were dependent on the organization for long periods of time for food and shelter, the individuals were considered employees under the FLSA. Id.


90 29 C.F.R. § 553.101. See also 29 C.F.R. § 553.104. Some examples of services that might be performed on a volunteer basis when motivated by such intentions include “helping out in a sheltered workshop or providing personal services to the sick or the elderly in hospitals or nursing homes; assisting in a school library or cafeteria; or driving a school bus to carry a football team or band on a trip. Similarly, individuals may volunteer as firefighters or auxiliary police, or volunteer to perform such tasks as working with retarded or handicapped children or disadvantaged youth, helping in you programs as camp counselors, soliciting contributions or participating in civic or charitable benefit programs and volunteering other services needed to carry out charitable or educational programs.” Id.

91 29 C.F.R. § 553.101.


93 Id.

94 Id.

95 Id.

96 Benshoff v. City of Virginia Beach, 180 F.3d 136, 140 (4th Cir. 1999).

97 Id.

98 29 C.F.R. § 553.106.

99 Id.

100 29 C.F.R. § 553.106. See Evers v. Turt, 48 F.3d 319, 320 (8th Cir. 1995) (finding that $35/day for service election clerks and $50/day and $.25/mile for travel reimbursement for service as election judges did not take individuals out of their volunteer classification); cf Krause v. Cherry Hill
Fire Dist., 969 F.Supp. 270, 273 (D.C. N.J. 1997) (finding that firefighters were employees not volunteers when they were paid eight dollars an hour and then their pay was reduced to twenty dollars per shift).


102 29 C.F.R. § 553.102. One of the factors used to determine whether the two agencies are separate is whether they are treated separately for statistical purposes in the Census of Governments issued by the Bureau of the Census, U.S. Department of Commerce. Id.

103 29 C.F.R. § 553.103. When making a determination of whether the individual is performing the same type of services, the Administrator will consider, among other things, the duties and factors contained in the definitions of the three digit categories of occupations in the Dictionary of Occupational Titles. Id. Some examples that would constitute the same type of services is a nurse working for a state hospital and claims to volunteer to perform nursing services at a state health clinic which does not qualify as a separate public agency, or a firefighter claiming to volunteer as a firefighter for the same public agency. Id.

104 29 C.F.R. § 553.102.

105 Id. For example, if town A and town B agreed to mutually aid each other in fire protection services, a firefighter from town A could still continue to volunteer service as a firefighter for town B. Id.


107 Ark. Code Ann. § 11-4-203(3) (Supp. 2009). Nonprofit recreational or educational camps that do not operate for more than seven months in a year are also one of the many occupations that are not included in the definition of employee. § 11-4-203(3)(L). Also not included in the definition is “[a] nonprofit child welfare agency employee who serves as a houseparent who is: (i) directly involved in caring for children who reside in residential facilities of the nonprofit child welfare agency and who are orphans, in foster care, abused, neglected, abandoned, homeless, in need of supervision, or otherwise in crisis situations that lead to out-of-home placements; and (ii) compensated at an annual rate of not less than thirteen thousand dollars ($13,000) or at an annual rate of not less than ten thousand dollars ($10,000) if the employee resides in the residential facility and receives board and lodging at no cost.”

108 There could be a different interpretation as to a volunteer who refuses to take compensation as in Alamo, because the definition for wage in Arkansas is not as expansive as the FLSA definition. However, the Arkansas statute does deal with issues of board, lodging, apparel, and other extra items in a separate statute. Ark. Code Ann. § 11-4-213.