

BEST GOVERNANCE PRACTICES

Frank Sommerville, JD, CPA

First, I want to explain to this presentation is not about meeting minimum legal requirements. Second, one size does not fit all churches. Third, the primary goal of this paper is to suggest the best ways to achieve compliance in today's heavily regulated climate. Under no circumstances should these suggestions be applied in a way that would diminish accountability or transparency. In the final analysis, these suggestions guide churches who are seeking to fulfill their exempt purposes while also fulfilling their stewardship responsibilities. In this paper, I use the term "Board" to address the governing body of the church. In some traditions, the governing body will be the Session, Vestry, Board of Elders, Board of Deacons or Church Council.

1. FULFILLING THE CHURCH'S MISSION

At least once per year, the Board should review all activities of the church to determine whether the activity assists the church in fulfilling its mission effectively. The Board should require output measurement from each activity. The Board should determine whether each activity is the highest and best use of the church's resources to accomplish that portion of its mission. This review and assessment should be included in the minutes of the meeting.

At least annually, the Board should review the articles of incorporation and bylaws of the church to determine whether the church is complying with all governance requirements created by either these documents. Every three to five years, the Board should engage an attorney to advise the Board whether amendments are needed because of changed circumstances.

2. OVERSIGHT

The Board's role is to provide non-spiritual accountability to the clergy and staff conducting the church's business. This requires establishment of a working environment that balances establishing policies and procedures against implementation of those policies and procedures. Usually, the chairman of the Board and the senior clergy member should establish a close working relationship.

A majority of the Board's members should be independent and unrelated to each other and staff members. At least annually, each Board member should review the church's conflict of interest policy and affirm in writing that the Board member is seeking to comply with the policy. A sample conflict of interest policy is attached as **Appendix A**.

The Board should review all policies and procedures annually to determine whether they are being followed and whether they are appropriate under the circumstances. The Board should also consider abolishing any policies not considered useful and adopting policies as needed to address current circumstances. The Board should consider engaging a human resource professional every three to five years to assist in its review.

Transparency is achieved when each Board member discloses to all other Board members all information and analysis that may be relevant to the Board's decision-making. The Board should require the same transparency from clergy and senior staff members. Each Board member should have reasonable access to staff members with the approval of the Board chairman and/or senior minister.

The Board is responsible for reviewing clergy and senior staff compensation and performance within IRS safe harbors.

3. COMPENSATION

The clergy and senior staff compensation should be set by the Board or a Compensation Committee. Each member of the decision making body must be free from conflicts of interest. That body should meet without the physical presence of the subjects of the meeting. The Board or Committee should determine all aspects of compensation, including retirement plans (qualified and unqualified), health insurance, disability insurance, cafeteria plans, expense reimbursement and all other fringe benefits.

The Board or Committee should receive adequate information to make an informed decision about compensation. In smaller churches, a Board member or Committee member should call similar churches to determine the amount of compensation that is paid to their ministers. In larger churches, the Board or Committee should engage a compensation expert to render a report regarding compensation paid under the same or similar circumstances to a similarly qualified individual. The compensation report shall be included in the minutes of the Board or Committee meeting.

In setting the amount of the total compensation, the Board or Committee should take into consideration historical compensation paid by the church, the financial condition of the church, the tenure of the employee, and how this compensation is appropriate considering the mission of the church.

4. SAFEGUARDING INTELLECTUAL PROPERTY

The Board is charged with safeguarding all assets of the church, including its intellectual property. If intellectual property is created within the scope of the duties and responsibilities of an employee, then the intellectual property is owned by the church. If the church's assets are used to create intellectual property, then the church likely owns the created intellectual property. See **Appendix C** for more information.

The Board should determine what intellectual property is being created by employees. It should review job descriptions to determine which positions are likely to create intellectual property that is bound by the church. It should then adopt policies and procedures to safeguard that intellectual property. A sample intellectual property policy is attached as **Appendix B**.

If the church and an employee determine that the intellectual property should be owned by the employee, the Board should then provide a written employment contract vesting

ownership with the employee and prohibiting the employee from using any church assets in the creation of the intellectual property. The Board should consider whether the lack of ownership of intellectual property has a negative impact on compensation of that employee. Further, the Board may want to consider whether to seek a licensing agreement with the employee that will allow the church to use the employee's intellectual property.

Appendix A

NONPROFIT ORGANIZATION, INC.

Policy on Conflicts of Interest and Disclosure of Certain Interests

This conflict of interest policy is designed to help directors, officers and employees of the **NONPROFIT ORGANIZATION, INC.** (referred to as “**ORGANIZATION**”) identify situations that present potential conflicts of interest and to provide ORGANIZATION with a procedure which, if observed, will allow a transaction to be treated as valid and binding even though a director, officer or employee has or may have a conflict of interest with respect to the transaction. The policy is intended to comply with the procedures prescribed in Texas Organizations Code, Chapter 22, Section 22.230, governing conflicts of interest for directors of nonprofit corporations. In the event there is an inconsistency between the requirements and procedures prescribed herein and those in Section 22.230, the statute shall control. All capitalized terms are defined in Part 2 of this policy.

1. Conflict of Interest Defined. For purposes of this policy, the following circumstances shall be deemed to create Conflicts of Interest:

A. Outside Interests.

(i) A Contract or Transaction between ORGANIZATION and a Responsible Person or Family Member.

(ii) A Contract or Transaction between ORGANIZATION and an entity in which a Responsible Person or Family Member has a Material Financial Interest or of which such person is a director, officer, agent, partner, associate, trustee, personal representative, receiver, guardian, custodian, conservator or other legal representative.

B. Outside Activities.

(i) A Responsible Person competing with ORGANIZATION in the rendering of services or in any other Contract or Transaction with a third party.

(ii) A Responsible Person’s having a Material Financial Interest in; or serving as a director, officer, employee, agent, partner, associate, trustee, personal representative, receiver, guardian, custodian, conservator or other legal representative of, or consultant to; an entity or individual that competes with ORGANIZATION in the provision of services or in any other Contract or Transaction with a third party.

C. Gifts, Gratuities and Entertainment. A Responsible Person accepting gifts, entertainment or other favors from any individual or entity that:

(i) does or seeks to do business with, or is a competitor of ORGANIZATION; or

(ii) has received, is receiving or is seeking to receive a loan or grant, or to secure other financial commitments from the ORGANIZATION;

(iii) is a charitable organization operating in the United States of America;

under circumstances where it might be inferred that such action was intended to influence or possibly would influence the Responsible Person in the performance of his or her duties. This does not preclude the acceptance of items of nominal or insignificant value or entertainment of nominal or insignificant value which are not related to any particular transaction or activity of the ORGANIZATION.

2. Definitions.

A. A "Conflict of Interest" is any circumstance described in Part 1 of this Policy.

B. A "Responsible Person" is any person serving as a Director, officer, employee or member of the Board of Directors of ORGANIZATION.

C. A "Family Member" is a spouse, parent, child or spouse of a child, brother, sister, or spouse of a brother or sister, of a Responsible Person.

D. A "Material Financial Interest" in an entity is a financial interest of any kind, which, in view of all the circumstances, is substantial enough that it would, or reasonably could, affect a Responsible Person's or Family Member's judgment with respect to transactions to which the entity is a party.

E. A "Contract or Transaction" is any agreement or relationship involving the sale or purchase of goods, services, or rights of any kind, the providing or receipt of a loan or grant, the establishment of any other type of pecuniary relationship, or review of a charitable organization by ORGANIZATION. The making of a gift or contribution to ORGANIZATION is not a Contract or Transaction.

3. Procedures.

A. Prior to board or committee action on a Contract or Transaction involving a Conflict of Interest, a director or committee member having a Conflict of Interest and who is in attendance at the meeting shall disclose all facts material to the Conflict of Interest. Such disclosure shall be reflected in the minutes of the meeting.

B. A director or committee member who plans not to attend a meeting at which he or she has reason to believe that the board or committee will act on a matter in

which the person has a Conflict of Interest shall disclose to the chair of the meeting all facts material to the Conflict of Interest. The chair shall report the disclosure at the meeting and the disclosure shall be reflected in the minutes of the meeting.

C. A person who has a Conflict of Interest shall not participate in or be permitted to hear the board's or committee's discussion of the matter except to disclose material facts and to respond to questions. Such person shall not attempt to exert his or her personal influence with respect to the matter, either at or outside the meeting.

D. A person who has a Conflict of Interest with respect to a Contract or Transaction that will be voted on at a meeting shall not be counted in determining the presence of a quorum for purposes of the vote. The person having a conflict of interest may not vote on the Contract or Transaction and shall not be present in the meeting room when the vote is taken, unless the vote is by secret ballot. Such person's ineligibility to vote shall be reflected in the minutes of the meeting.

E. Responsible Persons who are not members of the Board of Directors of ORGANIZATION, or who have a Conflict of Interest with respect to a Contract or Transaction that is not the subject of Board or committee action, shall disclose to the chair or the chair's designee any Conflict of Interest that such Responsible Person has with respect to a Contract or Transaction. Such disclosure shall be made as soon as the Conflict of Interest is known to the Responsible Person. The Responsible Person shall refrain from any action that may affect ORGANIZATION's participation in such Contract or Transaction.

In the event it is not entirely clear that a Conflict of Interest exists, the individual with the potential conflict shall disclose the circumstances to the Chair or the Chair's designee, who shall determine whether there exists a Conflict of Interest that is subject to this policy.

4. Confidentiality. Each Responsible Person shall exercise care not to disclose confidential information acquired in connection with such status or information the disclosure of which might be adverse to the interests of ORGANIZATION. Furthermore, a Responsible Person shall not disclose or use information relating to the business of ORGANIZATION for the personal profit or advantage of the Responsible Person or a Family Member.

5. Review of policy.

A. Each new Responsible Person shall be required to review a copy of this policy and to acknowledge in writing that he or she has done so.

B. As requested by the President or the Board of Directors, each Responsible Person shall complete a disclosure form identifying any relationships, positions or circumstances in which the Responsible Person is involved that he or she believes could contribute to a Conflict of Interest arising. Such relationships, positions or circumstances might include service as a Trustee of or consultant to ORGANIZATION, or ownership of a business that might provide goods or services to ORGANIZATION. Any such

information regarding business interests of a Responsible Person or a Family Member shall be treated as confidential and shall generally be made available only to the chair, the President, and any committee appointed to address Conflicts of Interest, except to the extent additional disclosure is necessary in connection with the implementation of this Policy.

C. This policy shall be reviewed annually by each member of the Board of Directors. Any changes to the policy shall be communicated immediately to all Responsible Persons.

Conflict of Interest Information Form
NONPROFIT ORGANIZATION, INC.

Name: _____

Title: _____

Please describe below any relationships, positions, or circumstances in which you are involved that you believe could contribute to a Conflict of Interest (as defined in ORGANIZATION's Policy on Conflicts of Interest) arising.

1. _____

2. _____

3. _____

I hereby certify that the information set forth above is true and complete to the best of my knowledge. I have reviewed, and agree to abide by, the Policy of Conflict of Interest of ORGANIZATION that is currently in effect.

Signature: _____

Date: _____

Appendix B

POLICY CONCERNING EMPLOYEE AUTHORED WORKS

FIRST CHURCH (“Church”), a Texas religious non-profit corporation, appreciates the efforts of its employees to accomplish its mission of spreading the Gospel of Jesus Christ. Many employees assist the Church by creating resources (such as teachings, sermons, music, books, videos, and manuals) that further its mission. For this effort, we are grateful. The Church has used these resources in its meetings and distributed them to the community. We believe these resources have greatly assisted those who have received it.

The Church seeks to stand behind the principles it espouses. All employees are loved and valued, regardless of the job description. The Elders want to break down any barriers that can hinder its ministry, especially the creativity needed to reach our world. It wants to reduce the chances of competition and rivalries among employees and also wants to treat all employees fairly.

Realizing that God’s work through FIRST CHURCH is much greater than any of those He has called to serve Him here, and further realizing that through our personal contributions to resource development, employees and contractors have an opportunity to freely give in furthering His work through FIRST CHURCH, the following is it’s Intellectual Property Policy:

All intellectual property created by employees, volunteers or contractors of FIRST CHURCH in the course and scope of their work for FIRST CHURCH will belong to FIRST CHURCH. All copyrights will be procured by FIRST CHURCH, all publishing contracts will be through FIRST CHURCH, and all royalties will be the property of FIRST CHURCH. If such efforts result in value received by FIRST CHURCH, then that value received shall be considered when evaluating the worker’s compensation, if any.

These steps are necessary to protect the FIRST CHURCH’s ministry. Anyone with questions concerning this policy, please contact _____.

Appendix C

INTELLECTUAL PROPERTY ISSUES Frank Sommerville, JD, CPA

1. What is intellectual property?

Intellectual Property (IP) is an umbrella term for various legal entitlements which attach to certain names, written and recorded media, and inventions. The holders of these legal entitlements may exercise various exclusive rights in relation to the subject matter of the IP. The term *intellectual property* reflects the idea that this subject matter is the product of the mind or the intellect. The term implies that intellectual works are analogous to physical property.

As used in this paper, IP includes speeches, lessons, songs, music, lyrics, arrangements, sermons, dramas, slides, videos, books, handouts, outlines, and any other means of communicating the Gospel. IP is protected by the United States Copyright Act ("Act"). IP includes copyrights, trademarks and service marks.

2. Who owns intellectual property?

Under the Act, the individual who created the IP owns the IP unless the Work for Hire Doctrine applies. Under the Work for Hire Doctrine, the person or entity who requested and pays for the creation of the IP will own the IP. The Work for Hire Doctrine means that the employer will own all intellectual property created by an employee within the scope and course of their duties as an employee.

To help understand the scope in an employment setting, you need to understand the employment relationship. If the employer controls the work to be done, provides a place for the work to be done, provides the equipment to assist in creating the work, or provides the means by which the work is created, all employee creations are owned by the employer. If an employer controls the schedule of the worker, has the right to define the assignments performed by the employee, pays the worker, or provides assistants, then the employer owns the employee creations. If the employer is in the business of producing such IP, then all employee creations used in the business of the employer are owned by the employer.

To change the Work for Hire Doctrine, the employer and employee must enter into a written contract, signed by both, before the creation of the IP and that contract must vest ownership in the employee.

The Act does not address the ownership of IP created by a volunteer. By analogy, some believe that a volunteer should be subject to the same terms as an employee. Other commentators believe that volunteers should own the IP. The courts examine the relationship between the individual and the church to determine ownership. Absent a written contract and the factors listed above related to employment, the courts will vest ownership with the volunteer. On the other hand, if the church provided all of the equipment in place for the creation of the IP,

and the IP was created at the specific request of the church the court may vest ownership with the church.

3. How do the tax rules impact the creation of IP?

Churches are tax exempt because they are described in Section 501(c)(3) of the Internal Revenue Code. This code section requires that the church be operated exclusively for exempt purposes. This means that all of its assets are required to be used exclusively pursuing exempt purposes. Further, the church's assets may not inure a benefit to a leader. If the Church enters into a contract with its pastor that vests all intellectual property ownership with him, it might lose its tax exempt status because of the inurement in favor of the pastor.

Since the church's assets are to be used exclusively pursuing exempt purposes, the pastor may not use any church assets to create IP that he owns. If he does use church assets by accident, he must reimburse the church for the fair market value of the use of those church assets. For example, the pastor uses his church secretary to proof his sermon. He must pay the church what he would have paid an independently employed secretary to proof the sermon. The cost of the secretary is irrelevant for computing the reimbursement required.

The church must also allow the pastor sufficient time off to create his sermons. The church should designate certain days each week where the pastor is not on call and not expected to perform any church duties.

The written contract with the pastor that vests ownership of IP with the pastor should also give the church a license to receive a single presentation of the sermon, a license to record the sermon, and a license to make copies of the sermon to give or sell to members.

This same structure should be used in dealing with any church employee who may create IP of which the church does not want ownership.

All written contracts dealing with IP should be reviewed by both an intellectual property attorney and a nonprofit tax attorney.

4. How does the church decide who owns IP created by employees and used by the church?

Absent a written contract, all IP created by employees is owned by the church if the IP was created as a part of the employee's job duties and responsibilities.

If a written contract exists, IP ownership vests according to the terms of the contract.

5. The church wants to give ownership of already preached sermons to its pastor. How can that be accomplished?

The transfer of IP to an employee is treated just like the transfer of any other property to an employee. The employee must pay income tax on the fair market value of the property being

transferred. The church must have the value of the IP determined by an independent appraisal. If the value when added to the other forms of compensation creates a payment of excessive compensation, then the pastor will owe a penalty called intermediate sanctions in the amount of 225% of excessive compensation. In addition to the penalty, the pastor must pay the church 100% of the excessive compensation. For example, the value of the sermons is \$10,000. If either the \$10,000 is not added to the pastor's taxable compensation, or the \$10,000 causes the pastor's compensation to be excessive, the pastor will write a check to the Internal Revenue Service for \$22,500 and a second check to the church and the amount of \$10,000.

The most difficult part of this transaction is determining the value of the sermons. For many pastors, the church will look at the prior revenues that the sermons have generated for the church to determine the value.

6. How do the IP rules apply to the music department?

Absent a written agreement, all music created by employees of the music department is owned by the church. In many cases, the IP will be considered a derivative work of an original. For example, if the music director created a new arrangement of a popular song, the new arrangement will be owned by the church. The creation of a derivative work usually requires consent of the original owner and payment of all royalties to the original owner.

In the music department, job descriptions become very important in determining ownership of IP. For example, if the music director's job description does not include writing new songs and affirmatively requires that the employee not use any church resources except within the written duties, the song writing will not be considered within the scope of the music director's duties and responsibilities. In that case, all songs written by the music director off the clock and without any church resources will be owned by the music director