Nonprofit Board Governance
Lessons from the Corporate Side

By Susan F. Shultz

The one group with the power to decide the fate of a nonprofit organization, the board of directors, is the one group that is often randomly selected, poorly informed, rarely evaluated, and almost never held accountable.

The market is demanding increased transparency and accountability from boards. New compliance mandates, regulations and shareholder activism are the drivers, but governance is more than just compliance. And the clamor for improvement is overtaking the nonprofit world.

We have an opportunity to make a difference – to infuse nonprofit governance with best practices – to transform boards from being the problem into being the solution.

Better Boards = Better Organizations

All boards, even the best, can improve. Doing good in the name of a worthy cause does not exempt a board from abuse and bad practices. What better examples are there than the United Way, that squandered $100M targeted for 100 charities; the Red Cross; The Baptist Foundation; and The Fiesta Bowl – unhappily the list goes on.

Over two-thirds of all CEOs and corporate directors also sit on the boards of nonprofits. All too often, they fail to appreciate the commensurate responsibility – and the liability – of nonprofit service. There are, indeed, differences:

- Nonprofit boards are accountable to stakeholders rather than shareholders.
- Directors on nonprofits usually serve without compensation.

• Often, nonprofit directors are expected to raise money.

Constituencies are usually more dependent on nonprofits than are shareholders of for profit corporations, who can simply sell their shares if they are not satisfied.

However, the three key success factors for nonprofit boards are the same as those that drive effective for-profit boards:

- Board Make-Up
- Director Responsibility Engagement and Accountability
- Leadership of the Board

Board Make Up

Great people are the key to great boards. No checklist can ensure good governance. Only good people can. So, continuously build your board to be the best it can be with a thoughtful, proactive process that includes the following steps:

Define your board charter and structure. Consider the benefits of a smaller statutory board supported by a larger advisory council that can help raise funds.

Maintain a needs matrix. Chart the existing skills and attributes of the board members and identify future needs.

Create position profiles to address those needs. Begin with the criteria, not the person.

Proactively and objectively recruit directors.

According to a recent Board Source survey, the area of lowest board performance is board recruitment. The only person who won't serve is the one you don't ask. So be particular – and thoughtful.

Director Responsibility and Engagement

Essentially, boards address the big issues and help avoid fatal mistakes. The charge of every director is to protect and represent the interest of the stakeholders. The board of directors is the ultimate legal authority within the corporation and is responsible for the business and the policy of the organization.

A board should focus on the future success of the enterprise. The board should pull the organization toward fulfillment of its vision. Management should execute. So the board focuses on policy, oversight and strategy. *Volunteering or fundraising are not substitutes for oversight.*

The most important thing a board does is ensure the right leadership is in place and has the resources to fulfill the mission of the organization. Next is to ensure the continuity of that leadership through substantive evaluations, communications and a meaningful succession policy.

Directors must be reasonably well informed. It is expected that directors will do their homework. If information is not provided in a timely manner, a director has a responsibility to obtain it. For example, directors should know what the key metrics of the organization are, the budget, the marketing plan, critical risks, etc. Too often, directors know only what the CEO and CFO tell them.

Directors should regularly attend meetings. Directors are liable for all board decisions taken while they are board members, regardless of whether they are in attendance or involved in the decision-making process. Board members are directors 24/7, not just for the meetings.

Directors should participate in decisions in good faith with the care of a prudent person.

Good judgment is required and provides the safety net against any lawsuits. Board members may rely on information from experts and employees. However, they should not rely solely on positions of others. Every board decision is the responsibility of every director. Directors should not be afraid to register dissent. In fact, it should be encouraged and welcomed.

IRS has a model Conflict of Interest Policy putting forth best practice.

1. Each year, directors should sign a statement acknowledging receipt and comprehension of and adherence to a onflict of interest policy.

2. Directors should recuse themselves from participation in discussions and any votes that may involve conflict of interest.

3. Directors should submit information on other organizations in which they are substantively involved and provide information about any possible conflicts.

Arizona law provides immunity from civil liability to a volunteer for an act of omission by the volunteer resulting in damage or injury. Such immunity applies if the volunteer acted in good faith and within the scope of the volunteer's official functions and duties for the nonprofit corporation, and if the damage or injury was not caused by willful, wanton or grossly negligent misconduct by the volunteer.

Two provisions of the Sarbanes-Oxley legislation pertaining to for-profit corporations extend to nonprofit organizations.

1. There must be so-called whistleblower protection, providing a confidential means of allowing whistleblowers to be heard and to ensuring there is no retribution for whistleblowers.

2. There must be a document retention policy, which prohibits altering, covering up, falsifying or destroying documents.

Other Responsibilities: Oversee the money

Know how the chief executive is compensated, what the components of the pay package are, the entire value of the annual compensation package and any trends in the compensation.The IRS requires nonprofit board members to set compensation levels at fair market value and to determine the proper price of goods and services.

Leadership of the Board

There are five key areas nonprofit boards should address:

- Fundraising;
- Board composition and diversity;
- Strategic planning;
- Focus (need to be more strategic and less operational); and
- Board Commitment and Engagement.

Above all, the board must insist on integrity and the highest ethics. The chair must inform and trust the directors and empower the board.

The agenda should be focused on strategic issues. Ideally, the board chair will create the agenda, gain input from other directors and then collaborate with management to refine and execute. The responsibility of ensuring effective meetings does not fall on the Chair alone. It extends to every director.

Accountability and transparency are increasingly expected and demanded. There should be annual evaluations and governance education to improve the effectiveness of the board. (See *www.theboardinstitute.com* for information on an independent, web-based solution to director education and board assessment accredited by RiskMetrics Group.) As a rule, we find out how much good governance counts when something really bad happens. Last year, more than 97 percent of corporate boards conducted evaluations compared with just over half of nonprofit boards. Most directors say an effective board evaluation is the most important technique for ensuring that directors improve or continue to perform at peak levels. Boards that conduct evaluations are rated 17 percent more effective.

IRS Section 990 contains the majority of regulations pertaining to nonprofit governance, and nonprofits must annually file the Section 990 form. Ideally, the IRS form 990 will be available publicly and posted on the organization's website. The IRS is likely to add regulations to Section 990 and increase oversight. Further, Congress is likely to pass a "Sarbanes-Oxley" for nonprofits.

States, too, are tightening regulations. Directors in New Jersey are required to be "board certified." In California, organizations with budgets over $2 million must prepare audited financial statements

We often hear about the boards that fail. We don't hear about the hundreds of great boards that avoided crises because of the dedication, integrity and contributions of good directors. If we don't govern well, government will do it for us. Better boards mean better organizations. AZ CPA

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