33 Keys to Building a Trustworthy Organization

Every nonprofit organization should apply these proven principles.

By William C. Lathen

Nonprofit organizations' bedrock foundation is public trust. Without it, their lifeblood, charitable giving, stops flowing. Ensuring such trust through ethical behavior is at the core of a report, by Independent Sector's Panel on the Nonprofit Sector, that suggests 33 principles for nonprofits to follow.

Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations is a far-reaching document to which all nonprofits should give their utmost attention.[1] While some of the principles may be more compelling than others for your organization, take the time to consider each one. Together, these sound and proven principles will enhance legal compliance, governance, financial oversight, and accountable fundraising. The report is organized into four categories:

Category 1: Legal Compliance & Public Disclosure (Principles 1-7)

1. Comply with all applicable federal, state, local, and international laws and regulations. Be sure your board, at a minimum, has a general understanding of the rules under which your organization operates. Board members should obtain appropriate legal help so that they may properly perform their oversight duties. The document cites an IRS free online workshop at www.stayexempt.org related to tax compliance. Each board member should be required to view these interactive sessions.

> Use these principles to assure a good reputation for your organization.

2. Create a written code of ethics to which all board and staff members adhere.

3. Establish a policy to manage conflicts of interest. (A conflict of interest is present when a board or staff member's duty to the nonprofit conflicts with a personal or financial interest.) Require all board and senior staff members to sign the policy and disclose any conflicts of interest when they join your organization and again every year.

4. Implement a policy to encourage people to come forward with information on illegal practices or violations of organizational policies. This "whistle-blower" policy should specify that no one who makes good-faith reports will be retaliated against or have their confidentiality violated. Since this policy must include your state's laws, you'll probably need attorney assistance. Be sure your policy states to whom people should report the misdeeds. Make sure you have transparent procedures to investigate reports and take appropriate action.

5. Develop policies and procedures to preserve your organization's important documents. Some documents (such as board minutes and papers related to your exempt status) are held permanently. Others, particularly tax returns, have federal time requirements. Federal laws are quite specific about maintaining the integrity of documents related to legal proceedings.

6. Protect your organization's assets – financial and human resources; programmatic content and material; integrity and reputation; and property – against damage or loss. On a yearly basis, analyze risks. Should insurance protection be obtained? Are board members fully aware of personal liability potential? Are documents adequately backed up, copied, and preserved?

7. Make information about your operations widely available to the public. Consider how to disseminate your Form 990, information about your organization's vision and mission, and your board members' names. One way to do so is to develop a Web site with this information, including links to your annual tax return.

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Category 2: Effective Governance (Principles 8-20)

8. Be sure you have a governing body (board of directors) responsible for reviewing and approving your organization's mission, strategic direction, annual budget, key financial transactions, compensation practices, and fiscal and governance policies.

9. Take care that your board meets regularly enough to fulfill its duties. The report states that board meetings are often held three or four times a year. If your organization has excellent staff and a strong committee structure, twice a year may work. A strong board president will organize effective committees to carry out the board's governing work between meetings.[2]

10. Make certain that your board periodically reviews its size and structure. The board should have enough members to allow for full deliberation and diversity of thinking. Except for very small organizations, this generally means that the board should have at least five members.

> An audited financial statement is the best way to maintain public trust.

11. Check to be sure your board includes members with the diversity, experience, and skills necessary to advance your organization's mission. It's helpful to include different ethnic, racial, gender, and other perspectives. Since the board has financial and tax requirements, it's important that the board include a competent CPA or someone with similar expertise.

12. Be sure that a substantial majority (at least two-thirds) of your board members are independent. In other words, they shouldn't:

> Without public trust, nonprofits' lifeblood, charitable giving, stops flowing.

(1) be compensated by the organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) receive, directly or indirectly, financial benefits from the organization (except as a member of the charitable class served by the organization); or (4) be related to or live with anyone described above. Note that this principle is not a 100% rule, so it's all right to have some board members that lack this independence (such as the paid director). A list of organizations excluded from this principle are found at www.nonprofitpanel.org.

13. Assure that the board hires, oversees, and annually evaluates the chief executive's performance. The board should conduct such an evaluation before making any change in the CEO's compensation (unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living). Annual evaluations with predetermined standards for performance are important. Changes in compensation, other than routine inflation adjustments, should be approved by the full board, even if a salary committee does the work.

14. If your organization has paid staff, ensure that the positions of chief staff officer, board chair, and board treasurer are held by separate individuals. If you don't have paid staff, take care that the positions of board chair and treasurer are held by separate individuals.

15. Design a process for educating board members about their legal and ethical responsibilities, their oversight functions, and the organization's programs and activities. A strong nonprofit will have an effective orientation for board members, both in writing and in person. Ongoing members also need this training periodically. The report recommends that someone knowledgeable about board liability, such as an attorney or insurance agent, explain the legal protections available to board members.

16. At least every three years, make certain that board members evaluate their performance as a group and as individuals. The board should have clear procedures for removing board members who are unable to fulfill their responsibilities.

17. Have the board establish clear policies and procedures setting the length of terms and the number of consecutive terms a board member may serve. For example, allow for a maximum of five three-year terms.

18. At least every five years, have the board review organizational and governing instruments, including articles of corporation and bylaws. The board should follow state law to amend bylaws that are no longer practical or appropriate.

19. Make sure the board reviews the organization's mission and goals and evaluates, at least every five years, the organization's programs, goals, and activities to ensure they advance its mission and make prudent use of its resources. Every board should set strategic goals and review them annually.

20. Note that board members are generally expected to serve without compensation, other than reimbursement for costs incurred for board work. If board members do receive compensation, take great care to ensure the services are necessary, the amount is reasonable, documentation is clear, and any potential conflicts of interest are addressed. Use comparability data to determine the amount to be paid, document the decision, and provide full disclosure of the amount and rationale for the compensation to anyone who asks.

Nonprofit World • Volume 26, Number 3 May/June 2008
Published by the Society for Nonprofit Organizations
5820 Canton Center Road, Suite 165, Canton, Michigan 48187
734-451-3582 • www.snpo.org

Category 3: Strong Financial Oversight (Principles 21-26)

21. Keep complete, current, and accurate financial records. Be sure your board receives and reviews timely reports of the organization's financial activities. Have a qualified, independent financial expert audit or review these statements annually. An audited financial statement is the best way to maintain public trust. Small nonprofits can receive pro bono auditing help from a CPA firm. The risk of financial misuse is too great not to conduct yearly audits. Larger organizations should establish an audit committee, independent from the board.[3]

22. Be certain that your board institutes policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization's annual budget and monitor performance against the budget.

The report states that financial management is one of the board's most important roles. Clear policies should be developed to protect financial assets. One of these policies should assure that there is a separation of staff duties so that different people receive, deposit, and spend the organization's cash. If there aren't enough employees to ensure such separation of duties, one or more board members or volunteers should be enlisted.[4]

23. Be careful that your organization doesn't provide loans (or the equivalent, such as loan guarantees, purchasing or transferring ownership of a residence or office, or relieving a debt or lease obligation) to your organization's directors, officers, or anyone related to them. Making loans is bad business. The public trust risk related to making loans and having something go wrong is too great. The report does state that if loans are made to an employee of the nonprofit, it must be reported on the annual Form 990 and 990-PF information returns.

24. Take care that your organization spends a significant percentage of its annual budget on programs that pursue its mission. Watchdog organizations recommend that at least 65% of total expenses should be for program activities. Your budget should also provide enough resources to run the organization effectively and to raise funds. Effective boards ensure the costs are appropriate and necessary and that there's an adequate budget to pay for them.

> It's important that the board include a competent CPA or someone with similar expertise.

25. Create clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of your organization. Such policies should require that travel on your organization's behalf be undertaken in a cost-effective manner. To avoid excessive expenditures, consult "IRS Publication 463: Travel, Entertainment, Gift and Car Expenses" and "IRS Publication 1542: Per Diem Rate Tables" (www.irs.gov).

26. Neither pay for nor reimburse travel expenditures for spouses, dependents, or others who are accompanying someone conducting organizational business unless they, too, are conducting such business. If this principle is violated, tax law requires that the benefit be reported as compensation to the spouse or dependent (except for de minimis costs like the expense of a meal at a function where a spouse or guest is expected).

Category 4: Responsible Fundraising (Principles 27-33)

27. In solicitation materials and other communications addressed to donors and the public, clearly identify your organization, and provide clear, accurate information, including the name of anyone soliciting contributions, the name and location of the organization that will receive the contribution, a description of its activities, the intended use of the funds to be raised, and a contact for obtaining additional information. Also note whether the individual requesting the contribution is a volunteer, paid employee of the organization, or hired solicitor. Proof that contributions are tax-deductible should be accessible – for example, on your Web site or in a copy of the IRS letter in your solicitation materials. If a donation isn't tax-deductible, you must reveal that information at the time of solicitation. A "Donor Bill of Rights," endorsed by many nonprofits, is posted at www.nonprofitpanel.org.

28. Use contributions for purposes consistent with the donor's intent as described in solicitation materials or as directed by the donor. If you don't receive enough donations to pursue the advertised reason for making the contribution, let all donors know of the situation. You may ask if you can use the funds elsewhere but, if not approved by the donor, the funds should be returned. Communicate any changes in how you spend the funds through a written agreement.

29. Provide donors with gift acknowledgments and information to help them comply with tax requirements. The IRS requires a written statement to the donor, mailed by January 31, stating the donor's annual contribution. If you provide goods or services in return for a gift, give donors a good-faith estimate of the fair market value of those goods or services. Fair market value isn't your cost but the price the donor would normally pay for the goods or services. For example, if donors are invited to a dinner in recognition of their gifts, you must let them know the value of the dinner, and they must subtract that value from the amount they deduct on their taxes.

If you receive an in-kind donation, don't value the property for the donor; it's the donor's responsibility to find an expert to do so. If you receive used personal items,

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Put the Principles to Work

A wealth of *Nonprofit World* articles (available at www.snpo.org) provide concrete steps you can take to put the 33 principles into action. For example:

- **The Ethics Audit: A Tool Whose Time Has Come** (Vol. 13, No. 6)
- **Conflict of Interest in the Board Room** (Vol. 17, No. 2)
- **Safeguarding Your Assets: A Board's Obligation** (Vol. 14, No. 4)
- **To Accept Or Not: A Guide to Dealing with Tainted Money** (Vol. 19, No. 1)
- **How to Prepare Board Members to Govern Effectively** (Vol. 25, No. 6)
- **Values for Ethical Choices: Rate Yourself** (Vol. 10, No. 3)
- **Compensation Reviews: More Important than You Might Think** (Vol. 25, No. 1)
- **Does Your Board Need Liability Insurance?** (Vol. 12, No. 6)
- **Evaluating the Top Administrator: A New Approach** (Vol. 15, No. 4)
- **How Effective Is Your Board? A Rating Scale** (Vol. 8, No. 5)

such as clothes and household items, note on the receipt what condition the goods are in. Tax laws require that all donations be in "good condition," or no deduction is allowed.

Prudent practice calls for you to write a letter of appreciation immediately after receiving a donation. It's also a good idea to keep donors informed about the activities they're supporting.

30. Adopt clear gift-acceptance policies, based on your exempt purpose, to determine whether accepting a gift would compromise your organization's ethics, financial circumstances, program focus, or other interests. Some donations can create major problems for a charity and the donor. Gifts may be illegal or unethical. They may create environmental protection law liability or unrelated business income. If an in-kind gift is received and later sold, it may cause major tax disadvantages to the donor. A well-thought-out gift-acceptance policy will protect your organization, your board and staff members, and your donors. (See, for example, "Do You Have a Policy for Real-Estate Gifts?", *Nonprofit World,* Vol. 25, No. 3, www.snpo.org).

Each board member should be required to view the free online workshops related to tax compliance at www.stayexempt.org.

31. Train and supervise anyone soliciting funds on your behalf to ensure that they understand their responsibilities and applicable federal, state, and local laws, and that they don't coerce, intimidate, or harass potential donors. Provide every fundraiser, whether paid or volunteer, with easy-to-understand materials for potential donors. If you use an outside firm to raise funds, be sure you have a clear contract describing the requirements of your organization and the firm. Confirm that state registration laws are met and that federal rules on telephone, e-mail, and fax solicitations aren't violated. If you or your representative offer legal, financial, or tax advice to donors, always add that they should consult with their own counsel.

32. Never compensate fundraisers based on a commission or a percentage of the amount they raise. Many professional organizations prohibit fundraisers from receiving commissions based on the amount contributed. Even if this activity doesn't violate professional ethics, it should be avoided. It is unprofessional and can lead to all sorts of negative results in the long run. It can also cause the public to conclude that your employees are paid "excessive compensation," hurting your public image and future fundraising.

33. Respect donors' privacy. Except where disclosure is required by law, don't share donors' names and information without letting them "opt out" at least once a year. If you do want to give out information about donors, discuss it with them first and ensure confidentiality if that's their wish.

Circulate These Principles

This list of principles will help you improve your operations, become more accountable, and win people's trust. Be sure to distribute this article to your board and staff, and use it to initiate discussion and improve any gaps in adherence to the 33 principles. And visit www.nonprofitpanel.org to sign on to the principles and show your commitment to the highest standards of ethical operation.■

Footnotes

[1]The Panel on the Nonprofit Sector was created at the encouragement of the U.S. Senate Finance Committee to promote transparency in the nonprofit sector. The report, published by Tax Analysts, can be found at www.taxanalysts.com. More information about the Panel is at www.independentsector.org. To develop these principles, the Panel incorporated a careful review of feedback and counsel from a diverse group of experts.

[2]See "Can Standing Committees Contribute to High-Impact Governing?", *Nonprofit World*, Vol. 25, No. 2 (www.snpo.org).

[3]For advice on performing an audit and creating an audit committee, check out these *Nonprofit World* articles at www.snpo.org: "How a Small Organization Can Audit Its Books" (Vol. 8, No. 4), "The Audit Committee: Why You Need One, How to Form One" (Vol. 16, No. 6), "How to Find the Perfect Auditor" (Vol. 22, No. 3), "Nonprofits without Audit Committees Risk Disaster" (Vol. 22, No. 2), and "How to Have an Audit without Breaking the Bank" (Vol. 20, No. 4).

[4]To learn more about the separation of duties, take a look at "Protecting Your Organization's Assets: A Primer on Internal Control" (Vol. 9, No. 2), available at www.snpo.org.

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