Turnaround Needed!

How to Get Started

Here's why the nonprofit sector is in trouble—and what to do next.

BY GARY SNYDER

When will nonprofit leaders step up and say, "Enough malfeasance is enough"? In the midst of numerous nonprofit scandals, the foundation world has also been rocked by exposés.

Until recently, foundations haven't faced external scrutiny. Now, with the hot spotlight of Congress, the IRS, and several attorneys general, we learn that foundations aren't what we thought them to be.

What Are the Problems?

Each incident is different, but they all boil down to greed—and an environment that lets those we trust betray us.

A recent study[1] notes that up to three-fourths of foundation trustees are taking ***hefty fees*** for doing as little as showing up at a few board meetings each year. The study sample wasn't small—it included almost 240 funders. These trustees receive more than $31 million in fees.

Another way trustees are enriching themselves is ***self-dealing***, the act of foundations purchasing services from board members. A study[2] shows that 30-55% (depending on size and type) of foundations receive professional services from board members. In an effort to skirt IRS intermediate sanctions rules, some board members are offering quality services to their organizations at below-market prices.[3] If trustee fees are coupled with actual services, sanctions are hard to enforce.

A third way to gain benefit as a trustee is to obtain ***grants for board members' organizations***. A few examples are illustrative: The Ken Lay Foundation and the Enron Foundation gave nearly $2 million to a healthcare institution whose leader was on Enron's board.[4] The New York Stock Exchange (NYSE) and its foundation, both nonprofits, gave 40% of the grants to NYSE board members' charities.[5] Because of these and similar activities, federal legislation has been introduced to require the disclosure of such corporate philanthropic grant making.

Another tactic foundation trustees use to curry community favor is the use of ***discretionary accounts*** that they're free to allocate as they see fit. Distribution of funds isn't linked to the foundation's mission, nor is there much due diligence. The only requirement seems to be that the recipient agency must be a 501(c)(3) nonprofit organization. In some instances, these discretionary grant pools can be as much as 40% of grant money expended by the foundation.

On the 501(c)(3) front, a federal grand jury, coupled with the U.S. Department of Labor, is looking into the finances of United Way of the National Capital Area in Washington, D.C. A 216-page audit reveals that several top managers helped themselves to benefits, including cash, with little board oversight. The IRS is examining the Nature Conservancy's Form 990 and investigating allegations of mismanagement, board corruption, and staff financial recklessness. The U.S. District Court in Michigan sent the finance chief of the Capital Area United Way (Lansing) to four years in prison and ordered her to pay about $2.1 million because of her embezzlement, forgery, and illegal monetary transactions. She had an addiction to collecting quarter horses.

Though small in number, these scandals reflect on the entire nonprofit sector. Before Congress, the IRS, and the SEC take action against us, we must start policing ourselves.

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What Can You Do?

All the above examples involve poor board governance. Recent studies[6] find that a strong board leads to an effective organization. Using these studies as a compass, here are ways to build your organization's capacity—the first step toward avoiding such problems and restoring the sector's reputation:

- **Form a strong board nominating committee** to recruit people with the talents your board needs, including financial and legal expertise. Pinpoint board requirements related to your organization's goals. Review candidates' qualifications to be sure they have the necessary skills and commitment.
- **Ensure that all board members** either hold an office or serve on a committee. Such involvement fosters accountability and makes certain that each board member takes an active role.
- **Require the board to evaluate the executive** on an ongoing basis. Establish and perpetuate high expectations for performance. Have the executive report to the board on a weekly or monthly basis, and conduct a formal assessment once a year.
- **Ask all board members to assess themselves** and the board as a whole. Discuss the results, and work on ways to improve.
- **Create clear, written expectations** of board members, including fundraising obligations.
- **Follow the IRS's intermediate sanctions rules** to assure that board members don't receive inappropriately generous salaries, fees, or benefits.
- **Conduct a needs assessment.** Identify gaps in your staff and board. Use training to shore up weaknesses. Ongoing education for board and staff—including the executive—is essential. Financial training is especially vital.
- **Comply with board practices** outlined in the Sarbanes-Oxley Act. Although the Act targets corporations, its measures to tighten accountability, including certifying accuracy of financial statements and creating audit committees, are relevant to nonprofits. If nonprofits don't adopt these rules themselves, they may see such rules thrust upon them. See "Crisis in the Board Room," *Nonprofit World*, Vol. 21, No. 5 (www.snpo.org).
- **Set up a a control system** to monitor your finances. Conduct a monthly internal financial review. Be sure that different people are responsible for the duties of receiving funds, depositing them, and keeping the records.
- **Assess your financial reporting,** and check that the information is accurate and honest. Make your financial information available to all stakeholders.
- **Hold an independent** financial audit every year. Appoint an audit committee of independent directors with financial management expertise. This committee should work closely with the auditor.
- **Build a partnership** between board and executive so that information flows freely between the two. Serve as a check and balance for each other.
- **Be sure staff and board members base decisions** on the organization's mission.
- **Prepare an ethics policy,** and perform an ethics audit. Avoid any semblance of self- dealing, conflict of interest, or other impropriety.
- **Monitor client satisfaction,** and exceed clients' expectations.

These procedures will help your organization become more actively managed—and actively governed.[7] Proactive involvement is the key. It's the best way to assure accountability and regain the public's trust. ■

Footnotes

[1] *Foundation Trustee Fees: Use and Abuse*, Georgetown University Center for Public and Nonprofit Leadership, September, 2003.

[2] Council on Foundations survey.

[3] IRS intermediate sanctions rules require compensation and benefits for nonprofit board members and executives to be reasonable. See "How to Be Sure Compensation Is Reasonable," *Nonprofit World*, Vol. 17, No. 1 (www.snpo.org).

[4] Council of Institutional Advisors.

[5] Hilzenrath, David S., "Directors' Charities Got NYSE Money," *Washington Post*, September 18, 2003.

[6] Herman, Robert and Richard Heimovics, *Board Practices, Board Effectiveness and Organizational Effectiveness in Local Nonprofits*, Nonprofit Sector Research Fund, Aspen Institute, nsrf@aspeninstitute.org.

[7] See the following *Nonprofit World* articles at www.snpo.org: "A Board Member Self-Assessment" (Vol. 15, No. 6), "CEO Evaluation: The Board's Second Most Crucial Duty" (Vol. 8, No. 3), "Nonprofits without Audit Committees Risk Disaster" (Vol. 22, No. 2), "Setting Up a Control System for Your Organization" (Vol. 16, No. 3), "The Ethics Audit: A Tool Whose Time Has Come" (Vol. 13, No. 6), and "The Sarbanes-Oxley Act & Nonprofits: But I Thought That Didn't Apply to Us," Vol. 22, No. 5.

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