Who's Minding the Store?

By Gary Snyder

There has been an astonishing amount of nonprofit malfeasance. Many of the largest nonprofits in America's are leading the way. A few examples:

The United Way — the largest group of agencies to which working Americans directly contribute — has been rife with questionable activity. In Lansing, Michigan, the United Way president stepped down when an employee was accused of embezzling almost $2 million. United Ways in Washington, D.C., Silicon Valley, and Chicago are facing similar trust issues.

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The largest nonprofit bankruptcy occurred when the Baptist Foundation of Arizona perpetrated a pyramid fraud on its elderly and retired parishioners. The accounting firm of Arthur Anderson of Enron fame aided in this disgrace. The damage: $590 million.

The cases of nonprofit wrongdoing continue to rise. Yet, some nonprofit leaders see these cases as aberrations, while others cover up misconduct for fear of bringing attention to their own organizations' problems. Still others worry that exposing impropriety will harm the sector's image and good

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works. What they overlook is that the publicity is far worse when uncovered by outsiders than if raised from inside the sector.

It's no surprise that less than 50% of the public has confidence in nonprofits' ability to carry out their missions and make wise decisions (as reported in "How Can You Gain Your Donors' Trust?", *Nonprofit World*, Vol. 21, No. 6). We'll never mend that trust till we look closely at our own organizations and how we manage them. Here's a rundown of the problems we need to confront:

What's the Problem with Nonprofit Boards?

Our nonprofit system is based on oversight by directors. They have the ultimate responsibility for the nonprofit organization. Although they're supposed to represent the interests of the community and stakeholders, many have, by default, relegated their authority to the staff executive. They fail their obligations because they don't understand that the buck stops with them, not the staff.

Few board members even know what their duties and responsibilities are. That's because they've never been told. Board orientation of any consequence is conducted by less than half of all nonprofit organizations.

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If a board meets several times a year and members sit on a few committees and prepare diligently for meetings, they're spending less than an hour a week in nonprofit business. That's not enough time to ferret out problems. Such limited board involvement, paired with a strong executive, has led to undetected mismanagement and nonprofit disasters.

Proper checks and balances

The common denominator in all these cases was the enabling environment in which the board let the staff function.

haven't been a priority. Nonprofit boards have failed the minimal litmus test of good governance by acquiescing to management's recommendations. Many boards, for example, fail due diligence requirements in not watching over the organization's resources.

Board incompetence can best be illustrated by the fact that most members can't even read the financial statements prepared by staff. As a consequence, they're at the mercy of executive staff members, who typically have questionable skills in that area as well.

And there's a major issue brewing on the board front. Many capable board members are leaving. More than one and one-half million board seats are vacant or being turned over in nonprofit organizations. Many of these board members are departing over concerns about liability exposure, as lawsuits against board members become more common. Others are turning away from board service because they're tired of antiquated procedures.

Furthermore, it's increasingly hard to find nominees with the skills to help set the board's direction. There is no pipeline of quality candidates for board membership. This void portends even worse decision-making and increased legal exposure.

What's the Problem with Outside Monitors?

Outside monitors aren't doing a good job of scrutinizing nonprofits. For example:

Stakeholders are rarely in the loop. Nonprofit organizations' most important constituencies are involved only tangentially. They connect with the organization only at annual meetings or an occasional formal dinner and have no idea what's really going on.

Accountants, auditors, and attorneys examine the organization's financial information merely to confirm its accuracy, not to certify how well operations are functioning. If they discover questionable activity, they may be reluctant to report it for fear of losing a client. Many nonprofits even use their accounting firms as consultants — a clear conflict of interest.

Local, state, and federal regulatory agencies are minimally staffed and often ill-prepared to respond to increasing malfeasance.

The courts have only recently become involved. In nearly every case, the nonprofit in question has done everything possible to stay out of court to avoid public scrutiny. Discrete settlements have been the typical resolution to fraud cases.

The media seldom cite nonprofit conflicts of interest or lack of accountability. The mainstream press hasn't given nonprofit malfeasance a high priority. In rare cases of large press coverage, the result has been a significant drop in contributions (as in the *Washington Post*'s coverage of the D.C. United Way scandal, which initially led to a 40% plunge in donations).

What's the Problem with Nonprofit Staff?

In too many cases, the staff has seized absolute power. By surrendering their authority to staff, board members have unleashed dreadful consequences. In the for-profit sector, a similar lack of board oversight led to Enron, Tyco, and the rest. The nonprofits have their scandals because they lack financial and conflict-of-interest controls. The common denominator in all these cases was the enabling environment in which the board let the staff function.

When board members bring up serious questions, staff members frequently view them as obstacles or even enemies. The staff maintains a chokehold on information, and board members become outsiders.

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The board's inaction serves staff members' interest. They can do pretty much what they please, and directors don't challenge or even scrutinize them. Neither staff nor board realizes that the key is to create a symbiotic partnership between the two.

What Can We Do to Take Control?

Perhaps the bull market and its residual effects masked some nonprofit sins. The good economy created powerful incentives not to dwell on problems when, in the past, such troubles effectively went away.

They won't go away any longer. It's up to us to act. Here are the concrete steps we must take:

What Boards Must Do:

Recruit, cultivate, educate, and retain the best possible board members. Make sure they are proficient in marketing, strategic planning, and financial management — areas that can secure a firm footing for your organization. Choose new members on the basis of skills and commitment, not "name" power.

Hold a comprehensive orientation for new board members. Clearly set out their responsibilities.

Exercise authority and oversight. Don't simply rubber-stamp the staff's recommendations. Take an active role in leading the organization.

Be sure that board members understand and influence financial decision-making and that they improve their financial skills actively and continually.

Be a resource for staff. Add value to the organization's deliberations, and monitor staff's performance.

Form an audit committee of several board members. This committee can oversee the organization's internal accounting controls in conjunction with an independent, outside auditor.

Use the organization's mission as a vehicle to coalesce the board, focusing on getting the directors on the same page to achieve a common purpose.

Perform a self-assessment to be sure all board members know their basic duties and are living up to them (see "How to Get Started" on page 24).

What Staff Must Do:

Commit to developing and maintaining a strong board. Spend time supporting the board and helping board members resolve problems.

Restore the balance of power to the board. Accept that the board is the final authority. View the executive director not as boss but facilitator, expediting the board's decisions.

Forge a strong executive team, composed of key staff members and led by the executive director. Use this team to work with board committees and help develop board agendas.

Share information openly and broadly with your organization's stakeholders and with the public. Make it clear that your organization is accountable and caring. Display your IRS Form 990 on the Internet (www.Guidestar.org).

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Accommodate all requests for financial information.

Maintain an internal control system that will root out fraud and error. Conduct monthly reviews of the organization's finances. (See "How to Conduct a Monthly Internal Financial Review," *Nonprofit World,* Vol. 9, No. 4, www.snpo.org.)

Provide professional-quality financial information to the board. Understand the rules of sound financial management, and be able to develop and use budgets.

Select a spokesperson to represent your organization. Be as forthcoming as possible with the media and others seeking information about your organization. Be honest about mistakes.

Move from a friendly relationship with board members to one that's more businesslike, with responsibilities clearly defined. A businesslike relationship makes it much more likely that problems will be identified and resolved.

What Board and Staff Together Must Do:

Create a partnership that's straightforward, ongoing, and continuous.

Focus on achieving staff and board buy-in to the organization's short and long-term goals and objectives. Without buy-in, there is no ownership; without ownership, there is no leadership.

Know the law, but go beyond legal requirements. Match your organization's actions to public expectations.

Measure your organization against standards provided by the Better Business Bureau's Wise Giving Alliance (http://Give.org).

Adopt a code of ethics that clearly prevents conflicts of interest. (See www.independentsector.org for a model to use. See "How to Get Started" box on this page for information on creating or reviewing your ethics code.)

How to Get Started

Start by reviewing these *Nonprofit World* articles, available at www.snpo.org/members:

10+ Self-Audit Tips for Nonprofit Accountability, Vol. 22, No. 4.

Nonprofits without Audit Committees Risk Disaster, Vol. 22, No. 2.

Protecting your Organization Against Financial Misuse, Vol. 17, No. 4.

The Ethics Audit: A Tool Whose Time Has Come, Vol. 13, No. 6.

Are You Fulfilling Your Financial Trust? The Three Key Financial Roles in Every Nonprofit, Vol. 17, No. 1.

The Sarbanes-Oxley Act & Nonprofits: "But I Thought That Didn't Apply to Us", Vol. 22, No. 5.

Learning the Ropes: Orienting New Members, Vol. 7, No. 5.

Board Member Self-Assessment, Vol. 15, No. 6.

How Effective Is Your Board? A Rating Scale, Vol. 8, No. 5.

Boards Can't Go It Alone: Forging a Partnership with the Executive Director, Vol. 14, No. 2.

Setting Up a Control System for Your Organization, Vol. 16, No. 3.

Boards category in ***Nonprofit World*** **CD-ROM.**

Board Governance Learning Institute program online at www.snpo.org/li.

Become familiar with the Sarbanes-Oxley Act, which sets out good governance practices. While this law focuses on corporations, many states are applying its regulations to nonprofits, making sure that nonprofit board members are qualified to serve and well-versed in their fiduciary roles. For more on this act, see "Boards Must Change the Way They Do Business," *Nonprofit World*, Vol. 21, No. 4, www.snpo.org.

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Use business-decision tools such as cash flow monitoring and competitive analysis. These tools will assess how your organization is doing with respect to other nonprofits and your own strategic plan.

Purchase comprehensive directors' and officers' (D&O) liability insurance to allay board members' fear of lawsuits.

Work with other nonprofit organizations to regulate the sector from within. This process could begin by forming a consortium of nonprofit leaders, including foundations, umbrella agencies, stakeholders, state associations, and others to work out best practices for nonprofits to follow. When defects are unearthed, spend time and money fixing, rather than covering up, those problems. Tougher oversight is coming, one way or another. If we don't reform ourselves, the legislature, attorney general, and Congress will thrust new regulations upon us. ■

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