



NAVIGATING THE FUTURE

soundwaves

Information and Risk Management Ideas for Not-for-Profit Organizations

The Pillars of Nonprofit Governance

Serving on a board involves more than just showing up for meetings

Governance is *the* buzzword these days. You can barely pick up a magazine, a business publication, or even the newspaper without finding an article talking about the subject. For example, *Newsweek* (11/19) reported that the Organization for Economic Cooperation and Development is “upgrading its principles for good corporate governance in response to the new challenges posed by a wave of global corporate scandals.” *Business Week* (11/24) had an article on the New York Stock Exchange’s new governance plan. And the *Wall Street Journal* (10/27) devoted an entire special section to corporate governance.

So what is corporate governance, and why should nonprofits care? Judith Burns, a *Dow Jones Newswire* reporter, wrote that corporate governance “is a hefty-sounding phrase that really just means oversight of a company’s management — making sure the business is run well and investors are treated fairly.”¹ Burns adds that when corporate governance works the way it’s supposed to, “a board of directors looks attentively over the shoulders of executives who smartly handle the day-to-day business decisions, and shareholders get a full accounting of the company’s operations and finances.”² Substitute *constituents and stakeholders* for *shareholders* and you’ve got a governance framework for the nonprofit world.

Of course, nonprofits have a different mission. While the main responsibility of corporate boards is to generate a financial profit for shareholders, Melanie Herman, executive director of the Nonprofit Risk Management Center, told *Soundwaves* that “the standards are different in the nonprofit boardroom.” She cites four elements of nonprofit governance: obedience to the organization’s mission, loyalty, care in managing risks and opportunities, and accountability to constituents and stakeholders. These may sound like simple concepts, but nonprofit boards must use great care in making sure they’re following these rules.

Obedience to the Mission

“One of the imperatives in managing a successful organization is to diversify your funding sources,” says Melanie Herman. “There’s a tendency to be entrepreneurial—which is a good thing—but sometimes also to pursue project activities for which there is funding but that may take you beyond the mission of your organization.”

Remember when the American Medical Association announced an agreement with Sunbeam Corporation? Under the 1997 deal, the AMA would have earned millions of dollars that could be put to use promoting issues important to physicians and their patients. Sunbeam, in turn, would have received an AMA seal of approval for its heating pads and other products—and

a likely leg up on its business competitors.

But what sounded like a win-win proposition to AMA board members turned out to be anything but positive as people tried to figure out what breadmakers and toaster ovens had to do with medicine. The outrage from both AMA members and the general public was quick and brutal, and editorial pages all across the country lambasted the association. In the end, the AMA pulled out and paid Sunbeam millions to settle a breach-of-contract lawsuit.

While the AMA-Sunbeam fiasco is a case study on what *not* to do, sometimes the problem is more subtle. For example, an after-school recreation program discovers a funding opportunity serving meals to children. But what does serving dinner have to do with teaching kids to play soccer? If the children are around for so long that they need to have dinner, perhaps the opportunity makes sense within the organization’s mission. If it doesn’t, but the board determines that serving meals would be a valuable program activity, then the nonprofit likely needs to change its mission from providing recreation alone to providing meals and recreation.

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Loyalty to the Organization

“When you sit at the board table and represent the organization, you have to put your personal interests aside and focus on what is best for the organization,” says Melanie Herman. Nonprofit boards often recruit lawyers, insurance agents, accountants, and others with valuable business skills to complement those directors on the board principally because of their passion for the organization’s mission. And once these professionals are board members, there’s a tendency to want to use them as advisors.

Problems often arise from the best of intentions, such as when a nonprofit hires the lawyer or the accountant on the board to work for the organization. “There’s the potential for the interests and perspectives of the person to diverge from what’s best for the organization,” warns Herman. “It doesn’t always happen, but it can happen.”

Take, for example, a board that decides to switch insurance agents and work with a board member. Then the nonprofit’s insurance premiums rise suddenly and dramatically. If the agent weren’t on the board, he or she would be out the door. But if you’re the CEO, and the agent is your boss, then it’s a dilemma for all involved.

Exercising Care

“Nonprofit board directors must exercise care in managing the downside risks and the opportunities that the organization faces and encounters on a day-to-day basis,” says Melanie Herman.

Being a good board member means a lot of things. Sure some are pretty obvious, such as reading your documents in advance, attending meetings and participating in discussions, and voting. But it also means “holding the staff’s feet to the fire and asking tough

questions,” says Herman. For example, are funding projections realistic? Is this program that we’re about to undertake consistent with our mission, or does it take us away from our mission even though it means a lot of new money?

Herman notes that it is important to approach all deliberations and

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— *Melanie Herman*

decisions “with eyes wide open and with a lot of thought and care about both the short-term and long-term future of the organization.”

It’s also important that board members, particularly finance committee members, have the skills necessary to thoughtfully review an organization’s financial statements. “And ask probative questions,” stresses Herman.

Herman notes that many board members do not understand nonprofit financial statements but are reluctant to admit it. “A good sign that the board doesn’t understand the statements is when they adopt them and there are no questions. Because even when there’s good news to be told, there have got to be some questions.” She recommends that CEOs and board chairs educate board members, whether by holding a workshop or a briefing or providing them with a booklet on nonprofit finances.

“You’re not doing your job if you allow your board to gloss over this information that is germane to the financial health of the organization,” says Herman.

Accountability

Unlike obedience, loyalty, and care — which are legal responsibilities — accountability to constituents and stakeholders isn’t a requirement. But, stresses Melanie Herman, “accountability is fundamental to effective governance in the nonprofit world.”

Accountability is difficult to define, and Herman argues that each organization has to decide for itself who it is accountable to and how to achieve it. A number of oversight groups have established benchmarking programs that nonprofits can adopt, but not the Nonprofit Risk Management Center. Herman believes that these programs do little to define whether a specific organization is working in the best interests of its stakeholders.

Herman cites as one example a nonprofit that undertakes an independent audit, a key element of many accountability standards programs. She points out that the audit doesn’t tell whether the organization is spending its money on mission-driven activities, or whether the money is in appropriate investments, or whether the staff is reporting to the board on a regular basis and in a thoughtful and informative way.

Finally, Herman stresses the importance of operating with transparency. “To me,” she says, “this means operating in the open and with a willingness to discuss what you do and how you do it with stockholders and anyone else who is interested. There’s very little to be gained by keeping something secret.” ♦

¹ “Everything You Wanted to Know About Corporate Governance...But Didn’t Know to Ask,” by Judith Burns. *The Wall Street Journal*, October 27, 2003.

² Ibid.

A Conversation About Nonprofit Governance

Jo Sachiko Uehara has extensive experience in the nonprofit sector, both as an employee of a nonprofit and as a nonprofit board member. Uehara recently left the YWCA of the USA after spending over 25 years in various positions within the organization, most recently as interim chief executive officer. She serves on the board of the Nonprofit Risk Management Center. She holds a BA in sociology from the University of Hawaii and an MSW from the University of Washington. Uehara sat down in mid-November to talk with Soundwaves about governance issues.

How has nonprofit governance evolved in the last few years?

There is a stronger focus now on accountability and transparency. As a result, boards must pay more attention to their roles and responsibilities in governing a nonprofit organization. They will also need to show more due diligence in terms of ensuring that there are internal controls in place to make sure that they are abiding by their constitution, bylaws, and mission.

Can you give me some examples of internal controls?

I would start with the board nomination process, and make sure that it follows the organization's mission and bylaws. Sometimes we're interested in a person who has a particular expertise, but we don't spend enough time on the nomination process and only find out

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when they join the board that they're not very familiar with the mission, the services, and/or the roles and responsibilities of being a board member.

Next, there needs to be an orientation for new board members. This is the responsibility primarily of the board chair or her designee, working with the CEO or her designee to design the program and pull together the materials. It could be run by a staff or board member, or a former board member, or even a panel of outgoing board members.

What should a board orientation entail?

The orientation should focus on the board's roles and responsibilities, including the board's relationship with the nonprofit's staff and CEO. You want them to know about the nonprofit's history, governance model, organizational structure, mission, services, and policies.

And while a good initial orientation is important, it doesn't stop there. There might periodically be a board education component in a board meeting to re-familiarize board members with an issue, or to let them know about new laws or new trends.

Risk Management

How should nonprofits manage risk?

It's critically important for nonprofits to pay attention to managing risk. Nonprofits should start by conducting an organizational risk assessment and developing a plan to minimize risk and exposure to liability and litigation.

There are times in which organizations do not intentionally forget about managing risk. It's just that you're so caught up in the day-to-day functioning that you don't put your resources and energy toward organizational infrastructure issues that are important in building and sustaining a nonprofit. These include basic areas of managing risk by boards and staff, including developing and implementing good policies and procedures. Something as simple as keeping good board minutes. Also, reviewing and monitoring financial reports, adopting an annual budget, developing a strategic plan, having operational plans, and making sure you have the proper kinds of insurance protection.

Audit Committees

Is an audit committee important?

I think an internal audit committee helps to monitor that the organization is being consistent with both its charitable mission and the laws. Having a committee to make sure that the organization is functioning in an accountable and transparent way is very helpful.

These days, I think it makes good sense for a board to be proactive. This is one way in which you can manage

risk in your organization.

Are there specific tasks that an audit committee should have?

In the past, audit committees focused on the external financial audit. But I think what is important going forward is for boards to look not only at the financial audit, but also at other areas in their organization.

Boards should look to make sure that appropriate policies are in place, whether it's a conflict of interest state-

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ment for board members, whether there are any confidentiality statements, that the employment policies are appropriate, that the organization is following through with grants and contracts, that all of the agreements — and the programs and services — are consistent with the mission. That there is an annual evaluation of the CEO. And that the organization and the board are showing due care financially and in a variety of other areas.

Accountability

What skills should boards be looking for?

You have to look at the nature of the organization. Generally, you want individuals who can look at the organization from a financial perspective, and legal, who are knowledgeable in fund development or have human resources expertise. Individuals should also reflect the diversity of the community. I think it really depends on the nature of the individual organization and what is necessary to provide good oversight.

What else can organizations do to be more responsive to the public?

There are mechanisms that can be set up to communicate regularly with the public. Let me use the YWCA as an example. The organization has a website, and an email newsletter that goes out weekly to keep people informed of what's going on both regionally and nationally. The YWCA has open board meetings so that members are free to come and observe. At times, the organ-

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ization has also had open forums. The organization has also established as part of its governance model, a regional council to provide input to the national board.

Standards

Do you think governance standards have value to an organization?

I think it is helpful for boards to have a checklist. One of the values of the Nonprofit Risk Management Center is the resources that it puts out, including a handbook for boards to become much more familiar with their responsibilities. It becomes very easy for a small community board that comes together because of passion on an issue to focus on delivering services to meet the mission that was created by their passion but to forget about the importance of all the governance and organizational development issues that make a healthy organization.

The Staff/Board Member Perspective

How has working for the YWCA informed your work as a board member?

I think it has helped me to clarify roles. It has made me more aware of the need to look at the big picture and focus on vision and strategic planning. I think that being a staff member serving on another nonprofit board also requires you to be much more aware of which hat you're wearing.

As for the other part — when a board member becomes a staff member — it's important that the board member revisit what her functions are. Because one is preparing and implementing and carrying out activities, and the other is policymaking and monitoring and evaluating and decision making.

Has being both a nonprofit employee and a board member been helpful?

There are some gray areas, and it is very easy for board members to get involved in the day-to-day administration of the nonprofit. And it is more difficult to look at the bigger picture in terms of visioning, monitoring, analyzing, and evaluating.

For example, it's easy to look at a line item in a financial report and ask, why is this line \$25 over rather than to analyze several years of audited financial reports to look at the trends in terms of expenses and revenue sources. Board members should be looking at what the economy looks like, and ask how do we position ourselves and manage the risk going forward.

With all this talk about governance, are boards becoming savvier?

I think there is a movement toward a smaller board, and one that is much more informed. Boards are more focused now on getting the kinds of expertise they need on the board to ensure that they are meeting their fiduciary responsibilities. So you're getting boards with the knowledge and the skill to carry out the charitable requirements and the mission of the organization. Boards are also becoming savvier about the importance of managing risk to build a sustainable organization, which I think is very positive. ♦



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