Board Governance: The Glass Remains Half Empty

By Marty Martin, JD, MPA

Two recent nonprofit board governance surveys highlight concern at efforts to improve board governance and accountability as the nonprofit sector seeks to avoid further legislation and regulation by adopting best practices. When viewed through the prism of the research findings related to: (a) board transactions and conflicts of interest; (b) fund raising; and (c) board self-monitoring and training, the studies suggest that board governance's "glass" remains significantly "half-empty".

In 2005, the Urban Institute (UI) conducted the first-ever national representative study on nonprofit governance, which surveyed a stratified random sample of nonprofit organizations. [1] Over 5,100 nonprofits participated in the study. The research findings were presented in UI's 2007 report, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study."

The "Nonprofit Governance Index 2007" (NGI) reports the findings of a study conducted by BoardSource. The study included two surveys - one for chief executives and one for board members. Findings are based on responses from over 2,100 BoardSource members that were nearly evenly divided between chief executives and board members. Since the study was not based on a weighted national sample, the findings cannot be assumed to be representative of all nonprofits. [2] In addition, BoardSource members were offered a choice of receiving one of four BoardSource publications in exchange for completing the survey. Given that BoardSource is a membership organization, which focuses on board governance as reflected in their mission, publications, and training, one might anticipate a heightened awareness to board governance issues in their members' responses.

Board Transactions and Conflict of Interest

A conflict of interest can arise from either financial or non-financial transactions involving a nonprofit organization and a board member and their families. The Internal Revenue Code and state corporate laws often prohibit or significantly limit financial transactions between board members and their organizations. If not completely prohibited, then good practice and policy require at a minimum: (a) full disclosure and transparency; (b) recusal by the affected board member from consideration of the conflicted transaction; and (c) a clear determination by disinterested board members that establishes, before the transaction occurs, that the conflicted transaction is in the organization's best interest.

The Urban Institute's report states that a "substantial percentage of nonprofits - including those engaged in financial transactions with board members - do not meet the standards laid out in the IRS draft and various other good governance guidelines in these areas." (p. 9) The IRS "draft" constituted IRS efforts to provide some guidance for minimal board governance practices. This draft suggested that a board "adopt and regularly evaluate a written conflict of interest policy that requires directors and staff to act solely in the interest of the charity without regard for personal interests."[3] It also suggested having written procedures for identifying and addressing conflicts. Finally, it encouraged written disclosure on a periodic basis and regular monitoring and enforcement of the conflicts policy.

The BoardSource study indicated that 88% of respondents had a conflict of interest policy, 87% required recusal from discussion, but only 67% required an annual disclosure statement. By contrast, the UI study indicated that among their respondents as a whole 50% had a written conflict of interest policy, but only 29% required an annual financial interest disclosure. More significantly, for those nonprofits reporting "financial transactions with board members, 60% have a conflict of interest policy and 42% require board members to disclose the financial interest they have in companies that do business with the nonprofit." (p. 9)

The UI percentages varied according to the size of the organization. The UI findings suggest that smaller nonprofits may engage in a review of transactions, but without written guidelines. Larger nonprofits may have written guidelines, but "significant percentages of nonprofit boards are not reviewing transactions beforehand to ensure that the formal policies are being met." (p.10)

These findings suggest more education, training, regulation, and/or enforcement may be needed to change board cultures involving actual or potential conflict of interest transactions. Efforts at public accountability might expect independent audits with management letters to highlight conflicted transactions and to compel boards to address conflicted financial transactions between board members and their organizations. However, BoardSource's findings indicate that only "roughly half of the nonprofit boards surveyed take steps to ensure that the audit is truly an act of independent oversight. Only 49% meet as a full board with the auditors and 37% meet with the auditors without staff present." (p.17) For smaller organizations even dedicating resources for an audit may be problematic.

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[1] For the Urban Institute's full report, see http://www.urban.org/UploadedPDF/411479_Nonprofit_Governance.pdf.

[2] For BoardSource's full report, see http://www.boardsource.org/dl.asp?document_id=553

[3] For the full draft of their recommendations, see "Governance and Related Topics–501 (c)(3) Organizations" at http://www.irs.gov/pub/irs-tege/governance_practices.pdf.

Fund Raising

Fund raising is not and should not be confused with board governance. However, fund raising is a fundamental responsibility for a board of directors. If the public is to invest in a nonprofit, then it is reasonable to expect members of the board of directors to provide financial support directly and to raise funds. These activities are relatively simple and easily understandable measures of board involvement and financial performance. Yet both surveys suggest that a significant percentage of board members were not actively engaged in fund raising activities.

The Urban Institute's survey responses indicated only 39% were actively engaged in fund raising. While 68% of BoardSource's respondents required board members to contribute personally, only 46% of respondents reported having 100% board participation in giving. "Fundraising ranks #1 among areas of board performance needing improvement" for BoardSource respondents. (p.6)

Monitoring and Training

BoardSource's report stated, "Competent board members are made, not born." (p.13) If serving on a board of directors is a learned skill, then boards might reasonably seek to improve their performance through activities like board monitoring, assessments, or training as a means to improve overall board accountability and organizational performance. The survey findings suggest boards generally do not engage in these relatively straightforward management practices.

Despite finding that board monitoring had an overall positive effect on an organization's performance, the UI survey indicated that only 17% were "very active" in monitoring the board's own performance. Interestingly, only 32% monitored the organization's programs and services.

BoardSource respondents indicated that 93% were interested in governance training. However, BoardSource's respondents also indicated that only "52% had done a board assessment, double the number since 1994." (p.13) Board self-assessment is the first step toward gaining an understanding of a board's strengths and weakness. Knowledge gained from a board assessment can then be used by the board to seek out appropriate governance training, which in turn could lead to improved organizational performance.

Conclusions

Peter Drucker noted, "Performance is the ultimate test of any institution. Every nonprofit institution exists for the sake of performance in changing people and society."[4] The UI report states, "Concerns about accountability, however, should not obscure attention to performance and effectiveness." None of these survey factors if implemented fully can either insure an increase in the quality of board's decisions nor improved organizational performance. However, the findings suggest much remains to be done.

At the core of the public and legislative concerns about accountability is the thesis that organizations that are more accountable will perform better and be more effective in both achieving the organization's mission and meeting its public accountability as tax-exempt organizations. Research findings concerning the three board governance factors previously discussed: (a) board transactions and conflict of interest; (b) fund raising; and (c) monitoring and training suggest significant concern as to the will and ability of the boards of directors to modify their practices, behaviors, and activities to achieve better organizational performance and public accountability. These factors represent three areas in which best practices are reasonably available to boards and can be readily adapted. However, without significant and substantive change, the nonprofit sector's efforts at self-regulation through best practices suggest further legislative responses and regulation to address board lapses in governance and management practices will be needed.

Future surveys by these two organizations could benefit by asking a common set of core questions to provide comparative data.

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[4] Drucker, P.F. (1990). *Managing the Non-Profit Organization: Principles and Practices*, New York: HarperCollins Publications, p. 139.

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