The Top 5 Governance Issues Facing Nonprofits Today

What are the most common governance challenges facing nonprofit organizations today? What steps should our leadership and board take to avoid common governance pitfalls? At SunTrust, we often hear organizations grapple with questions related to conflicts of interest, risk management, outcome measurement, investment oversight, and ethics.

Considering several recent examples of nonprofits entangled in scandal, it is prudent that organizations address governance challenges now to avoid potential pitfalls in the future. Empowering nonprofits with information, tools, and resources to overcome these challenges is a vital step to inspiring the highest level of confidence from stakeholders.

> **"The greatest threat to the not-for-profit sector is the betrayal of public trust."**
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> **Joel Fleishman**
> Scholar, Author, Professor of Law and Public Policy, and Director of the Heyman Center on Ethics, Public Policy and the Professions,
> Duke University

Issue #1 - Conflicts of Interest

Can board members be paid for professional services rendered to the nonprofits that they serve? Can a nonprofit executive hire relatives to fill positions under their direct management? Is it okay to rent office space at a discount from an advisory board member?

All nonprofits must be aware of potential conflicts facing their organization. The reputational risk of negative publicity is one of the greatest threats to the trust that nonprofits establish with their donors, volunteers, and members. In many ways, a simple conflict of interest policy is one of the most vital governance tools that a nonprofit can adopt. A well constructed policy defines transactions or agreements that might benefit the private interest of an officer, director or board member.

Once implemented, the policy should be circulated and discussed amongst board and staff annually. Any potential conflict of interest should be disclosed and documented with interested persons abstaining from any vote or discussion on the matter. It is important to remember that on the relatively new Form 990 tax return that taxexempt organizations file annually, the IRS asks whether your organization has a written conflict of interest policy and how conflicts are managed.

"There have been cases when large endowments allowed board member-directed investments to represent a significant portion of their multi-million dollar portfolio. While illegal activity was probably not involved, arrangements like this can appear as conflicts of interest. The best solution is just to avoid it," says Quanda Allen, Group Vice President, SunTrust Foundations and Endowments Specialty Practice. A 2012 study by the National Association of College and University Business Officers found that 55% of the 831 endowments surveyed allowed board members to do business with the university as long as the relationship is disclosed.[1]

Issue #2 - Risk Management and Personal Liability

Can board members be sued? If someone falls on property owned by a nonprofit, is the organization liable? Is it ok to sell donor databases to for-profit entities?

Risk management is everyone's responsibility in a nonprofit organization. From executive staff to volunteer leadership, proactive steps taken to mitigate risk improve the likelihood that a nonprofit won't be derailed by an unanticipated event. In fact, board members hold the ultimate fiduciary responsibility for a nonprofit's operations. However, a 2007 Urban Institute Study revealed that only 52% of nonprofits surveyed reported that their boards were "actively engaged" in setting organizational policy or financial oversight.[2] Clearly, this gap in responsibility is a risk to board members.

As reported in The Chronicle of Philanthropy, a $5.5 million judgment was levied against a New York nonprofit CEO, a subsidiary that he controlled, and the charity's five board members in January of 2013. A $1 million judgment assessed to board members was a penalty for their breach of fiduciary duty relating to complex financial arrangements between the charity, the CEO, and a company controlled by him and his wife.[3] This is an unfortunate example where board members faced personal liability which could have been avoided with a more rigorous risk management orientation.

If risk is not well managed, nonprofits jeopardize their tax-exempt status. To protect the opportunity to fulfill its mission, a nonprofit must undertake the task of putting risk management policies in place and of evaluating insurance as a way to transfer the financial impact of unknown occurrences with negative consequences.

Essential Risk Management Policies

- Confidentiality Agreement
- Conflict of Interest
- Document Retention and Destruction
- Executive Compensation
- Gift Acceptance
- Investment Management
- Whistleblower Protection

Issue #3 - Outcome Measurement

How do we know if we are fulfilling our mission? How do funders compare our performance to similar organizations?

"Nonprofit organizations often tell their stories by illustrating their impact on the lives of a single individual, family or member. While powerful, it doesn't replace a solid theory of change tied to specific, measurable outcomes. More nonprofits must make the transition towards measuring the impact of their programs and services," says Quanda Allen, First Vice President and Foundations and Endowments Client Manager.

The United States is home to 1,581,111 tax exempt organizations – a 30% increase from 1999 to 2009.4 As the number of tax exempt organizations rise, constituents are demanding a higher level of self assessment and outcome measurement. Beyond competition, the rationale behind this trend is heightened accountability. Stakeholders want to understand what difference a nonprofit's programs are making and how successful they are in fulfilling their mission. Integrating an outcome evaluation process into program design and measurement is essential for a nonprofit's long term sustainability. The process begins with a self assessment. The next step is to identify key elements of program evaluation and to implement a method for collecting data to manage daily performance. Benchmarking performance against other organizations in a similar program area is a meaningful practice that provides insight into areas of improvement and excellence.

Issue #4 - Investment Oversight

Is it mandatory to have board members with finance experience serve on the investment committee? Is a 5% spending policy a reasonable, achievable target considering the challenges facing the economy today?

In the wake of national investor fraud scandals and volatile economic markets, nonprofit organizations have responded by improving investment oversight. The process begins with the board of directors establishing a finance or investment committee. This committee is responsible for initiating an investment policy statement that clearly outlines the investment objective, roles and responsibilities, performance expectations, spending needs and any prohibitions.

The legal and fiduciary responsibilities of managing investment assets pose a significant challenge for nonprofits of all sizes and complexity. In many states, regulations like the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) provide guidance related to the governance of investment assets.

Issue #5 - Ethics and Accountability

Should our organization have a code of ethics? Are we required to retain documents for public review for more than one year?

Nonprofit organizations must foster a culture of ethics and accountability. Losing public confidence erodes the very foundation upon which the nonprofit organization is built. For most organizations, a great place to start is with a code of ethics that is rooted in the values, vision, and mission of the nonprofit. The adoption of a formal code provides staff, board, volunteers, and stakeholders with clear guidelines for making ethical choices.

Charity Navigator, Guidestar, the Better Business Bureau, and the Internal Revenue Service (IRS) represent just a few organizations that have increased pressure on nonprofits to make their financial transactions transparent. In 2002, Sarbanes-Oxley represented one of the most sweeping laws to impact tax exempt organizations in decades. Its provisions related to document retention/destruction and whistle blower policies were unchartered territory for most nonprofits.

Don't put off tomorrow what you can do today

Nonprofit organizations face a number of opportunities to improve how they govern. At the heart of the nonprofit and stakeholder relationship is trust. Even when funded by private dollars, nonprofits exist to serve community needs. Goodwill earned by responsible governance practices ensures that donors give, volunteers serve, and the public benefits.

1. 2012 NACUBO-Commonfund Study of Endowments
2. 2007 The Urban Institute Study, Nonprofit Governance in the US
3. Michael Peregine, "Price of Board Inaction: $5.5-Million for One Charity," Chronicle of Philanthropy, January 14, 2013.
4. National Center for Charitable Statistics -nccsdataweb.urban.org/PubApps/profile1.php?state=US

About SunTrust Foundations and Endowments Specialty Practice

SunTrust has nearly a century of experience working with not-for-profit organizations. Fiduciary stewardship is the heart of our culture. We are not merely a provider for our clients; we are an invested partner sharing responsibility for prudent management of not-for-profit assets. Our client commitment, not-for-profit experience and fiduciary culture are significant advantages for our clients and set us apart from our competition.

The Foundations and Endowments Specialty Practice works exclusively with not-for- profit organizations. Our institutional teams include professionals with extensive not-for-profit expertise. These professionals are actively engaged in the not-for-profit community and are able to share best practices that are meaningful to their clients. Team members offer guidance and advice tailored to the various subsets of the not-for-profit community, including trade associations and membership organizations. Our Practice delivers comprehensive investment advisory, administration, planned giving, custody, trust and fiduciary services to over 700 not-for-profit organizations. We administer $30.9 billion in assets for trade associations, educational institutions, foundations, endowments and other not-for-profit clients.[1]

[1] As of September 30, 2016

For more information about nonprofit governance issues, contact your relationship manager or call 866.223.1499. Please visit us at www.suntrust.com/foundationsandendowments or www.suntrust.com/nonprofitinsights

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