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Top Ten Non-profit Governance Mistakes (From a Lawyer's Perspective)

By Ellis M. Carter

Lawyers who regularly represent tax-exempt and non-profit organizations are eventually solicited for advice regarding non-profit governance. Often these questions drift into management issues. While always quick to point out that my expertise is in non-profit law, not management, I have summarized some of the most common governance mistakes I have witnessed in my practice.

1. Failing to Understand Fiduciary Duties. When you volunteer to serve as a director or officer of a non-profit, you accept the responsibility to act with the duties of good faith, due care and loyalty. You also accept the potential liability for failing to fulfill those duties. Increased scrutiny from the I.R.S., Congress, state attorneys general, the Department of Justice, donors and the media require vigilance at every step. It is no longer sufficient to rubber stamp committee or staff recommendations or to simply "abstain" from dicey decisions. Today, board service comes with real responsibilities and real consequences for those that fail to live up to them.

2. Failing to Provide Effective Oversight. Boards are entitled to delegate tasks to committees, officers, staff, or in certain cases, professionals, but only if they perform sufficient oversight. Oversight is commonly exercised through policies and procedures so long as the board ensures that the policies and procedures are actually followed. Common oversight mechanisms include review of financial statements and the annual Form 990 as well as the implementation of various governance policies. Popular governance policies for nonprofits include conflict of interest policies, executive compensation policies, travel and expense reimbursement policies, whistleblower policies, etc. Difficult tasks that require more time and focused attention can be delegated to committees. Common governance committees include those designed to oversee finances, investments, audits, and compensation.

3. Deference to the Executive Committee, Board Chair or the Organization's Founder. No one owns a tax-exempt non-profit. No one committee, director, or individual can control the organization. The executive committee, if one exists, is typically charged with acting on behalf of the board when the board is not in session and cannot be easily convened. It is, however, accountable to the full board and should not be permitted to operate as a "mini-board." The chair's primary duty is typically to preside over board meetings and to act as a liaison between the board and the chief executive. The chair does not have the power to override decisions of the board. Similarly, the founder may act as the chief executive and run the day to day affairs of the organization. The founder may also sit on the Board, but even founders serve at the pleasure of the board. The board has a duty to review the performance and set compensation for the chief executive and if necessary, reprimand or even terminate the chief executive.

4. Micro-managing Staff. For a non-profit organization with paid staff, once board members demand keys to the organization's offices and start making direct demands on staff that

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report to the Chief Executive, the board has crossed the line. The Board's key duties are to provide oversight and strategic direction, not to meddle in the organization's day to day affairs. Board members who cross this line are undermining the authority of the chief executive to their own detriment. If you cross this line, be prepared to quit your day job. Similarly, staff should not invite micromanagement by asking the board to take on day-to-day tasks that the staff should be handling. The size and budget of smaller organizations necessitates some blurring of these lines, but board members and staff should know their roles and attempt to adhere to them as much as possible.

5. Avoiding The Hard Questions. It is can be uncomfortable to ask tough questions or to disagree with one's fellow board members. However, group think rarely leads to sound decision-making. Often, the most valuable board members are the ones who, calmly and respectfully, speak their mind. It is important to set a tone that encourages a free exchange of ideas, both good and bad. Open, vigorous discussions about key issues should be encouraged. A board that passes every resolution "unanimously" should evaluate whether it needs to do more to encourage a thoughtful and open discussion.

6. Insufficient Conflict Management. If a conflict of interest is with an insider, their family member or business, its not enough to simply disclose the conflict and have the disinterested directors approve the transaction. In such cases, the disinterested members of the board need to consider alternative arrangements that do not give rise to a conflict of interest. If after considering alternatives, the board still finds the transaction with the insider is in the best interest of the organization, then the board should carefully document the basis for the decision and the fact that the interested director did not participate in the deliberations or vote. Best practice is to follow the procedures outlined in the intermediate sanctions regulations to properly analyze and document the proposed transaction.

7. Lack of Awareness of Laws Governing Tax-Exempts. Directors that hail from the for-profit world often assume nonprofits operate in a less-regulated environment. In reality, the opposite is true. Tax-exempt organizations enjoy an array of tax and other benefits. To ensure those benefits are not exploited; Congress and local governments have imposed additional legal requirements that tax-exempts must follow. It is essential that directors of tax-exempt entities be aware of the various federal, state, and local laws that apply to the organization. In our experience, many directors are unaware whether they are governing a private foundation, a public charity, a supporting organization, or another form of tax-exempt entity, all of which are subject to different limits on their activities. Board members should understand, at a minimum, the penalties they face for overpaying key employees or other insiders, for engaging in excessive lobbying or political activities, for making egregious bad bargains on behalf of the organization, the impact of failing to pass the public support test, etc. Board training and orientation for new board members is often the best solution.

8. Operating with Outdated, Inconsistent Governing Documents. Over time, many organizations change their mission and purpose without updating their governing documents. Similarly, many organizations develop governance practices that do not comply with their original governing documents. For example, it is not uncommon to see documents that call for voting members although no member votes have ever taken place. Similarly, it is not uncommon

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to see bylaws with a term that calls for the cessation of the organization on a date that has long since passed. Frequently, these issues stem from copying another institution's bylaws without regard to the distinctions between the organizations or current law. Encourage compliance by conducting regular reviews of the governing documents and checking the bylaws before electing additional officers or directors, creating additional committees, adopting amendments, etc.

9. Airing Disagreements Outside the Boardroom. Every board's motto should be "what happens in the boardroom stays in the boardroom." Inherent in the duty of loyalty that all board members must adhere to, is an implied duty of confidentiality. Once an issue is settled by board vote, the board members who voted against the majority must present a united front to the world. If a vote is so disagreeable that a board member cannot carry on in this manner, the board member should consider resigning. In extreme cases, if the board member believes the corporation's rights are being violated, the board member could join with likeminded board members to bring a derivative suit to enforce the organization's rights.

10. Failure to Cultivate Board Diversity. The initial board is typically made up of friends and advisors of the organization's founder. Over time, the initial board may reach out to their trusted friends and advisors to fill vacancies. This approach to board recruitment can lead to the "usual suspect" syndrome. This is where the same individuals who went to the same schools, belong to the same clubs, and hail from the same neighborhoods and professions are institutionalized onto an organization's board. If your organization is run by a group of "usual suspects," consider mixing it up by creating a matrix of skills, experiences, and backgrounds that would add valuable perspectives to the board. Those with law, accounting and fundraising skills are obvious choices. Substantive mission related skills are also important. For example, an educational organization may want to recruit a retired teacher or school administrator; whereas, a domestic violence shelter may want to include a policy expert, social worker, or someone who has been a victim of abuse.