

## ETHICS



# The Nonprofit Ethicist

by Woods Bowman

**D**EAR NONPROFIT ETHICIST,  
*One of our state's greatest authorities on nonprofits told me that the board of directors is collectively responsible for any misfortunes that may occur at our facility. Our executive director and the board's own executive committee keep the full board at arm's length, and many decisions are made "behind closed doors." So I passed along this expert's assessment to the full board, but they dismissed it. This is very frustrating. How should I proceed?*

*Frustrated*

Dear Frustrated,  
Your board is a disengaged rubber stamp. And, like a driver who disdains wearing a seat belt, all is well until it isn't.

You need a teachable moment to get your point across. How's this: The board of a small California organization did not realize it was paying the fundraiser by a formula that included a healthy commission. His compensation for the year was an astounding \$646,000—a nice boost to the household income of the executive director, who was married to him. When such stuff hits the press, the board

cannot absolve itself by saying, "Wha'? I didn't know!" It is the board members' responsibility to keep track of such goings-on.

Take a look at Simone Joyaux's article in this issue; she recommends getting rid of the executive committee altogether. In fact, why not send the article along to the board, while you're at it.

*Dear Nonprofit Ethicist,  
Some of our board members receive compensation from our organization. Our interim CFO is the board treasurer, and also president of the development company that we have under contract for an expansion of our campus. He is compensated both ways. Another board member is our real-estate agent, and he is handling the sale of an apartment building we own. He'll be getting a big commission. In the meantime, another board member is the property manager of the [above mentioned] apartment building, for which he [too] receives compensation. The board signs a conflict-of-interest policy, but I'm not sure everyone is above reproach. What do you think?*

*Disturbed*

It is rarely a good idea to mix business with board members: when a board member is both vendor and decision maker, the drivers behind the terms of agreement can easily get muddy. But if a contract with a board member is determined to be in the organization's best interest, just be sure that the board strictly follows the proper procedures laid out here.

Dear Disturbed,

If this column sponsored a contest for Worst Conflicts of Interest, your board would be a strong contender for the 2011 prize; the opportunities for a media train wreck are all there. According to the Ethics Resource Center, conflicts of interest head the list of behaviors that pose severe risk to nonprofits.

Your CFO-cum-treasurer-cum-vendor may be at risk of being sanctioned by the Internal Revenue Service, under section 4958 of the Internal Revenue Code, for receiving "excess benefits," and, unless the board followed the "safe harbor" provisions of the law, he will have the burden of proving that his total compensation (in all forms) was not excessive.

I have said it before, but I repeat it here: *it is best not to do any business with a board member.* Furthermore, the board should understand that being both vendor and decision maker puts the organization at risk on any number of levels.

Even if people observe the “letter of the law,” there is too much room for ethical slippage, and good board members with the right instincts should not have to have this pointed out to them.

There are really no good reasons to violate this commonsensical guideline. If you feel that a board member may get your organization the best possible business deal, ask him or her to resign before the decision to hire is made. And, even then, bid the job properly. Remember, it is not just reality you are dealing with here. In such situations, perception is as important as fact, and negative perceptions about an organization’s business affairs can cause irreparable harm.

The media and lawmakers are becoming ever more sensitive to such matters. There is a Massachusetts state bill on the fast track that will make it illegal to compensate nonprofit board members for their service, on the basis that compensation, per se, creates a conflict of interest, since trustees should not be mixing their own interests with the overriding interest of the public. The spark for that piece of legislation was the discovery that the board members of a local nonprofit health insurer that was being scrutinized for having given a departing executive a more-than-generous severance package had been similarly handsomely compensated.

Meanwhile, premiums had been rising quickly, and the question, “Who is watching out for the interests of the insurer’s customers and the public?” was raised. In this case, as it turns out, it was the Massachusetts attorney general.

That said, there is currently no law on the subject, but the IRS has strong opinions. The new 990 form asks whether an organization has a conflict-of-interest policy. Assuming that your board is not ready to fire its “helpful” members, it may benefit from reading and following the procedures outlined in Appendix A to

*the Instructions for Form 1023: Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.*

According to this document, a conflict of interest exists only after the board or one of its committees—after exercising due diligence and discussion in the absence of the interested person—determines that a financial interest rises to the level of a conflict by a majority vote of its “disinterested members”—that is, members without a stake in the outcome. If a conflict exists, the board may nevertheless approve the transaction if upon further investigation it determines that no better terms are available from a disinterested party, and that the arrangement is fair and reasonable and is in the organization’s best interest.

The minutes of the governing board and relevant committees should contain the particulars of the matter, and should include “the names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection with the proceedings.”

By the way, your conflict-of-interest statement should include an attestation signed by the board members verifying that they have received a written copy of the statement and that they have read, understood, and agreed to abide by it. The attestation should also note that the signers recognize that the tax-exempt entity is charitable, and that federal tax exemption requires that it engage primarily in activities that accomplish its tax-exempt purposes.

If your board followed all of the above procedures, the IRS would probably not find fault; but it still smells fishy to this bystander, and would make great scandalous copy for your local rag.

*Dear Nonprofit Ethicist,*  
*The president of the board and the executive director are having an affair. How will this affect the organization and those associated with it? How messy is this? How common is it?*

*Appalled*

Dear Appalled,  
Intraoffice affairs are quite common and always messy, and the largest messes occur between supervisor and supervisee . . . and at the top of the corporate ladder. This case is about as bad as it gets. The most basic job of a board is to hire, monitor, and, if necessary, fire a chief executive. An affair between the president and executive director compromises these functions.

Conversely, if the lovebirds should have a falling out, even a top-notch executive director may suddenly become unemployed. Other board members—the ones with integrity—will flee, leaving the organization to those who are too cowardly to confront the situation or who don’t mind an undercurrent of secrecy and half-truths. At the very least, the independence of the oversight function will have become compromised.

People never seem to think of these things when they start an affair, but that shouldn’t be surprising: it is well known that hormones are toxic to brain cells. This is a disaster waiting to happen, and one or the other (or both) should step down—voluntarily or otherwise.

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