



# The Nonprofit Ethicist

by Woods Bowman

If a board president and an executive director are closely related, the board's most important job—to hire and fire an ED—is compromised; if your brand-new organization has a potential financial conflict of interest with a founder, you face the risk of losing your tax-exempt status or even of going broke; and, it is probably not a good idea for an organization to accept an invitation to apply for a credit card at a board chair's bank.

**D**EAR NONPROFIT ETHICIST,  
*I was recently fired from the finance committee of a San Diego nonprofit (by its board president; I am not on the board of directors.) The board president is the interim executive director's mother. Although "technically" she leaves the room when personnel matters are discussed, she has "mentioned" to board members that her daughter will quit if the board goes through with an ED search rather than naming her daughter to the permanent ED position.*

*By firing me, she is holding back negative information about her daughter's management capabilities from the full board. (In my committee work, I uncovered many, many examples of the interim ED's financial mistakes.) The nonprofit is an affiliate of a large national nonprofit. I believe that the board president received bad advice*

*from the national office when she asked for counsel on the potential conflict of interest when her daughter was first up for the job; I think someone with authority told her it would be fine to continue as board president so long as she left the room during personnel discussions. Obviously, she is exerting influence in other unhealthy and/or unethical ways.*

*Here's my question: You and I both know it's wrong (right?), but how do I "educate" the misguided board and the national advisor about what is appropriate? I think they may need some remedial ethics training.*

*Out-in-the-Cold*

Dear Out-in-the-Cold,  
You're right, it's wrong. Tell the board that ethical rules in organizations are not to be followed for their own sake—unlike the Ten Commandments. They are essential to a sustainable organization

that attracts the best people to work for it. The "chemistry" between board chair and executive director is a critical component of a healthy nonprofit. They must be candid with each other and mutually supportive. However, each must be unafraid to be critical of the other, which is sometimes too easy and at other times too hard in a parent-child relationship.

The most important job of a board is to hire and fire an executive director. If the executive director is the board chair's daughter, the board cannot fire the daughter without deeply embarrassing the mother, whether the mother is in the room or not when the fateful decision is made. So, with all due respect to national headquarters, it is bad business and a spit in the eye of common sense for the board chair to be related to an executive director (or interim executive director). I would go further and broaden this prohibition to include any senior staff member. Either

the board chair should step down or the interim executive should leave right now. Assuming this does not happen, the board should wait until she threatens to quit if a search is launched for a permanent executive director, and then say, "Good, and goodbye."

*Dear Nonprofit Ethicist,*  
I'm helping a team of rural community leaders start a school for post-secondary career and technical education certifications. Eventually, the founders would like to offer associate's and bachelor's degrees as a member of the Work Colleges Consortium. For now, though, the biggest challenge is starting from the ground up and making sure we can responsibly use assets that are being made available. How does the fledgling board deal with the following potential conflicts of interest?

The man with the original idea was on the founding board of a similarly structured successful institution in the 1980s. He owns a hundred-thousand-square-foot warehouse as well as welding and machining equipment, which he would like us to use in our educational programs. In addition, as he is passionate about the cause and has experience implementing education systems, he is the obvious first pick for board president for this remote rural community. He is a master electrician and would not have time to be employed by the trade school beyond maybe teaching a class or two, but he is also interested in teaching.

His enthusiasm for volunteer service paired with teaching skills is a precious commodity to the founders, who want to involve as many people like him as they can. And, while the founders would prefer to lease the factory in incremental growth phases rather than buy it, after some investigation there is no comparably suitable space within fifty miles to be found, unless the organization were to purchase land and embark

on new construction, which is ridiculously more expensive than modifying a leased area to suit.

So there is much to consider: on the one hand, there may be conflict if the board feels that a move to another facility may be prudent in the future. And, is a person involved in everyday program delivery the best fit to serve as president? At this time active community volunteers have other commitments, and after six months of looking for alternatives, the trade school founder does seem the best to lead the fight during this initial establishment stage.

Are these such major conflict-of-interest problems that the IRS would likely deny the school's tax-exempt status?

*Anxious*

*Dear Anxious,*  
The IRS may not deny you tax-exempt status (I suspect it won't), but you could quickly go broke if you bought the building with borrowed money and it remained half empty. Leasing space incrementally with an option to buy is a better way to go.

The situation with the founder is made to order for conflict of interest (COI) problems. The board should adopt a COI policy right away. For guidance, see Appendix A to the instructions for Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.

Assuming you receive 501(c)(3) recognition, your founder could face Intermediate Sanctions (fines disguised as taxes) if he engages in less-than-arm's-length transactions with your organization—whether or not he is on the board. He could have more to worry about than you.

*Dear Nonprofit Ethicist,*  
An organization I am familiar with has a board chair who, in her day job, is

a banker. This chair invited the ED to apply for a corporate credit card at her bank. Assuming the chair's bank has competitive rates, is this unethical?

*Just Asking*

*Dear Just Asking,*  
An organization will find money management easier if it uses a corporate credit card issued by the same bank where it has a checking account. If it pays the bill in full every month, rates will make no difference. (Don't forget about annual fees.)

A bigger issue arises if the board chair works for the bank where the organization has its checking account. The chair could use her position to push the organization into borrowing for capital expansion instead of launching a capital campaign. With a long-term debt, borrowing rates matter big-time. Alternatively, if the board chair works for a rival bank, she may be setting her sights on using a credit card account as a hook to snag the corporate deposit account.

By the way, in a credit card deal, don't forget to establish a policy regarding side benefits for card users, such as airline miles. All side benefits should accrue to the organization, not individual users.

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