



Leading in Turbulent Times: What Your Board Can Do Now

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Primary Board Responsibilities

1. Establish Strategic Direction

- Determine mission and purpose
- Ensure effective planning

2. Ensure the Necessary Resources

- Ensure adequate financial resources
- Select the chief executive
- Build a competent board
- Enhance the organization's public standing

3. Provide Oversight

- Monitor and strengthen programs and services
- Protect assets and provide financial oversight
- Ensure legal and ethical integrity
- Support and evaluate the chief executive

✍ Notes:

Leading Through Turbulent Times “Aha’s”

Instructions: As you have listened to the presentations during the Forum and to your peers this morning discuss leading through turbulent times, write down “aha’s” that are relevant to your organization. An “aha” is 1) a promising or best practice, tool, or process; 2) an idea that excites you; or 3) a *new* or *deeper* understanding of something you already know.

My “aha’s”:

1.

2.

3.

4.

For those who are really inspired.....

5.

6.

7.

Facing the Financial Crisis: 8 Smart Things Your Board Can Do Now

In these very troubled financial times, organizations are looking to their boards for leadership. How board members react to the economic crisis can go a long way toward calming fears and ensuring that nonprofits remain solvent in this difficult environment and are even better prepared to enact their organizational missions in the future.

Following are 8 things boards can do now to address the financial crisis (it is, by no means, an exhaustive list as board may be coping in other ways):

1. Be a mission guardian.

Ensure that you, your fellow board members, and the chief executive recommit to forwarding your organization's unique mission and ensuring that all important decisions flow from the mission statement.

2. Work more closely with your chief executive.

Now is the time to increase communication with, and support of, the chief executive and staff and help them keep their spirits high. At the same time, adhere to a culture of transparency. If the financial situation is grave, work with management to keep staff apprised of developments. Long faces emerging from behind closed doors will only foster anxiety.

3. Get a realistic picture of your organization.

Set aside some time at your next board meeting to talk to the chief executive and chief financial officer and determine where the financial downturn is affecting your financial picture. Assess cash availability if your revenue is tied to market fluctuations; make sure that your cash, investments, or reserves are parked some place safe and are getting the best possible return. Check to see if you have a diversified funding stream, and, if not, develop a plan to diversify. Get an immediate and firm grip on all your revenue streams and be clear as to what is – or is not – genuinely bringing in revenue. This does not mean cutting all non-revenue or negative revenue programs; it does mean seeing the whole picture and where your real costs are with open eyes.

4. Think strategically.

Examine your organizational goals and strategies in light of the current conditions. Consider scheduling an additional board meeting, in person or by teleconference, to discuss your organization's short-term strategy. Then ensure that a review of the long-term strategy is on the agenda. Eventually, the financial crisis will end, and the markets will recover. Organizations that have continued to think strategically throughout the crisis will come out of it in the best position.

Now is the time to think how your organization can become more competitive. With fewer contributed dollars available, funders may reevaluate their giving plans. Organizations that position themselves as useful in times of crisis may actually find themselves the recipient of *more* gifts, not fewer.

Thinking strategically also implies being conscious of how the board frames the questions it will discuss, which in turn directs where discussions will go. For example, if the board asks, "Where do we cut expenses to make sure we can balance our budget?" the discussion will center around expense reduction. If the question is framed as, "How do we maintain a balanced budget?" the discussion will include expenses and revenue. If the board asks, "How best do we serve our mission despite changes in our economy?" the board is likely to have a broader and more fruitful discussion.

5. Tighten your belt.

Now is a good time to examine the feasibility of reducing expenses. Consider a reduction in board-related expenses. For example, board members who are reimbursed for their transportation costs to and from board meetings could begin to pay for their own travel expenses. Consider canceling a planned face-to-face meeting in exchange for a well-prepared teleconference meeting. Build cash reserves as you reevaluate the necessity of budgeted capital outlays. Is 2009 the year to invest in fixed assets or infrastructure? It may be. As suggested above, think strategically and remember that organizations that maintain their spending at near-normal levels during recessions are best positioned to excel during recovery.

6. Evaluate your compensation structure.

What could be worse now than newspaper headlines announcing the names of overpaid nonprofit executives? Benchmark your chief executive's compensation against survey data for comparable organizations. Such information has been compiled by *The Nonprofit Times*, Abbott & Langer, GuideStar, and *The Chronicle of Philanthropy*. Be prepared to discuss your findings with the chief executive.

7. Create a contingency plan.

Ask yourself, how might we have to govern our organization differently if the economy enters a long-term recession? Ask the chief executive and chief financial officer to work with the board treasurer or finance committee to develop an alternate financial model for the organization based on the assumptions derived from that exercise, and create a contingency budget to account for potential shortfalls. Think outside your current structure: For example, consider a collaboration or even a merger with another nonprofit with a similar mission if your organization is in serious financial difficulty.

8. Step up your fundraising.

While it may appear counterintuitive to increase development activities when funders are also affected by the downturn, being proactive in this climate may yield surprising results.

Call on key funders to discuss your situation and reaffirm their commitment to your organization's mission. Go beyond your usual suspects by considering nontraditional funding sources, and don't forget former donors.

Be strategic in how you look at both current and potential donors. Some industries will be hit hard by the economic downturn; others will be less affected by it. Examine your list of

constituents and stakeholders for organizations less affected and push harder on them than in the past. Conversely, step up your analysis of donors who have already pledged gifts for signs of financial distress to help anticipate possible contributed revenue shortfalls. Continue to recognize your current donors, too; it is still more cost effective to develop current donors than find new ones. Finally, but perhaps most obviously, use the crisis to your advantage: Don't be afraid to inform funders that your constituents need your organization's services now more than ever.

No one has a crystal ball. The economy may only dip, then recover quickly, or we may be headed into a prolonged recession. While we all hope for the former, boards that prepare for the worst – strategically, financially, and operationally – will be in the best position to fulfill their mission now and when recovery does occur.

Adapted from an article by Barry D. Gaberman, Board Chair, BoardSource, Washington, DC. This article originally appeared in *Board Member* (Volume 17, Issue 6, November/December 2008).

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A POSITIVE SIDE OF HARD TIMES

A 40-year (1967 to 2007) study of charitable giving patterns as they relate to recessions and economic slowdowns found that while there was an impact on giving, it wasn't as dire as conventional wisdom might assume.

- Giving grew an average of 0.8 percent in years with an economic slowdown.
- In years with eight or more months of recession, total giving fell an average of only 2.7 percent. Individual giving, which accounted for 80 percent of total giving, declined an average of only 3.9 percent. Foundation giving, which accounted for about 10 percent of total giving, dropped an average of only 0.1 percent. Corporate giving, which accounted for 5 percent of total giving, fell an average of only 1.6 percent.
- Human services organizations showed growth in giving in recessions (0.7 percent) and even higher rates of growth in longer recessions (5 percent). This may indicate an appropriate response to the level of need in difficult times.

Adapted from "Giving During Recessions and Economic Slowdowns" by the Center on Philanthropy at Indiana University. Giving USA Spotlight, Issue 3, 2008, Giving USA Foundation.

Building a Constructive Partnership NOW

What 3 things can you and your fellow board members do NOW to support the chief executive?

1.

2.

3.

Assess and Minimize Risk

- Be sure you have Directors' and Officers' insurance
- Be aware of the revised 990
 - New reporting requirements
 - More nonprofits must file
- Implement and enforce a conflicts of interest policy
- See that the organization maintains a good credit and financial standing
- Require the organization employs a professional auditor
- Pursue the warning signs

Understand the Organization's Finances

- Assess cash availability if your revenue is tied to market fluctuations
- Make sure that your cash, investments, or reserves are parked some place safe and are getting the best possible return
- Check to see if you have a diversified funding stream, and, if not, develop a plan to diversify
- Be clear about what is bringing in revenue
- Talk to your financial advisors

Finance Questions to Consider During Tough Times

- **REVENUE:** How might the reliability of your organization's revenue streams be affected in an economic downturn?
- **EXPENSES:** Will costs have to be cut, and if so, which costs?
- **OPERATING RESULTS:** How might changes in revenue streams affect operating results?
- **HEALTH OF THE BALANCE SHEET:** If changes in operating results occur, how will these changes affect your organization's balance sheet?
- **LIQUIDITY:** How will changes to the balance sheet affect your organization's liquidity?

Five Quick Questions for Your CFO

As a board member, you should know how the financial crisis is affecting your organization. Here are five quick questions you can ask your chief financial officer (CFO) or business manager to be sure you have a handle on how your organization is coping with the challenge. Pick up the phone now, ask the questions, and then suggest the CFO share the answers with all board members.

1. Are our cash equivalents truly liquid?

The phrase you'll often see on a balance sheet is "cash or cash equivalents." There's no trickery or hidden meanings here — the item refers to cash equivalents to which you can get immediate access. Your cash equivalents should pass two tests: They should be instantly available (online or with very little lag), and they should be available without penalty or loss. One of the things that distinguish cash from investments is that while investments may be able to be sold quickly, you may incur a loss if you sell them at the wrong time. As long as all of your cash equivalents truly are equivalent to cash, you can breathe a bit easier. But before you exhale right away, consider Wachovia's freeze on the education investment vehicle called the Commonfund earlier this month. Many colleges believed that their investment in the fund was "almost like a checkbook." After the freeze, they realized that when the Commonfund's president described using the fund "almost like a checkbook," he did not say it was "exactly the same as a checkbook."

2. How many days in cash do we have?

This metric is a simple one. If all cash stopped flowing into to your organization, and you kept spending each day at the same rate as before, how long would you last? It is a good sign for most nonprofits if the answer is 30-45 days. If you also have substantial investments lodged with an investment manager, and some of that money is always held in cash that isn't counted as a cash equivalent, that too is a good sign because it may be available in a pinch. If your financial person doesn't know what this ratio is, that's a bad sign.

3. What's our current ratio?

This metric divides your current assets by your current liabilities. If the result is 1.0 or greater, your organization should be OK in the short term. If it's less, your financial staff has work to do.

4. What's the status of our line of credit?

A line of credit allows the organization to draw money from a bank up to a certain amount. It is as though the money was sitting in the organization's cash account. The difference, of course, is that it is a loan, and the bank instantly starts charging interest on any drawdown. If the balance is zero, or if it is some manageable amount less than the cap on your line of credit, it's good news. One concern for later is that lines of credit are meant to be short-term financing. To enforce this principle, regulators stipulate that you must maintain a zero balance for 30 consecutive days during each year, although enforcement of this provision is not rigid. In times of tight credit, however, they may enforce the requirement, and it could be problematic for those organizations that are not used to following the provision.

5. Are we going to make a profit or show red ink this year?

In times like these, the most important immediate thing you can do is to stay profitable. Yes, profitable. Profit, borrowing, and capital campaigns are your only sources of capital as a nonprofit. Capital campaigns take a long time to plan and execute, and if credit is shut off or stingily given, your only source of capital is profit. Worse, a deficit eats into your seed corn, otherwise known as your net assets (the nonprofit equivalent of ‘owner’s equity’). Make sure your total incoming revenue for the year at least equals or, preferably, exceeds your total expenses. This is important because of the next question.

If you have an endowment, you will probably show a loss — but it depends on your fiscal year and what happens over the next several months. The nonprofits in the worst position are those with an endowment and a September 30 fiscal year end, which cuts off the year at the worst possible time. By that day, their endowment almost surely had lost a lot of value just like everyone’s retirement account did. These are called unrealized losses, and they can wipe out total operating profit.

Go ahead and speculate about the future — everyone is — but get the facts about your present situation.

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Investments

- Have an investment policy and strategy to guide decision making
 - 25% of nonprofits have updated their investment policy in the last year
- Have access to investment expertise, not just on the board but in a third party
- Ensure assets are diversified, rather than concentrated in one type of investment
- Know if your actions are subject to the Uniform Prudent Management of Institutional Funds Act

Diversify Your Revenue Streams

- Earned Revenue
 - Fee for service
 - Publication sales
 - Research new win-win project ideas
 - Sell or lease assets that are not needed (computers, office space)
 - Other examples?
- Be aware of Unrelated Business Income Tax (UBIT)
- Consider the risks involved with diversifying

Step Up Your Oversight

- Ask to see the financial picture monthly
- Don't micromanage

What Financial Information Should Board Members Review?

- Budget versus actual revenues and expenses
- Budget versus actual capital expenditures
- Debt payments
- Adequate financial information to support decisions such as:
 - a. adding or expanding programs,
 - b. acquiring property and equipment, and
 - c. making significant investments.
- Monitoring information in the following areas so that the board can provide adequate oversight.
 - a. Liquidity
 - b. Financial condition
 - c. Reserves
 - d. Revenue and expense activity
 - e. Compliance with donor restrictions, where applicable
 - f. Status of significant investments
- Information on programs and activities

Intermediate Sanctions

The IRS is paying more attention to the financial transactions of nonprofits. It is important that those in positions of influence understand the implications of the regulations and realize how they personally can be financially affected. Intermediate sanctions provide an incentive for insiders to play the role of watch-dogs against private exploitation of an organization's assets.

History

Traditionally, the IRS had only one tool, revocation of tax exemption, to use against nonprofits that exploited their exempt status by engaging in 'excess benefit transactions' in favor of someone in a position of influence within the organization. The organization had to pay the full price for an individual's wrongdoing. In 1996, the Tax Payer Bill of Rights II (Section 4958 to the Code) established specific excise taxes that could be imposed on 'disqualified persons' who receive or approve of excessive compensation within their nonprofit. The IRS has since fine-tuned these sanctions. New penalties seek to cover virtually all financial transactions that involve insiders, not only the most flagrant misconduct. The final updated IRS regulations were posted early in 2008.

Which organizations are affected?

501(c)(3) organizations, excluding private foundations, and 501(c)(4) welfare groups are covered. 501(c)(6) trade associations are not included.

Who is a disqualified person?

Anyone who has exerted substantial influence (not defined by the law) over the organization within the past five years is a disqualified person. Specifically the list may include: highest level managers, board members, founder(s), major donor(s), highest paid employees, family members of the above, and an entity where the listed persons own more than 35 percent of an interest.

What is excessive benefit?

Anything that exceeds fair market value or reasonable compensation for services rendered constitutes excessive benefit. These requirements complement the 'reasonableness' test which the IRS has yet to clarify.

Compensation:

- For purposes of the IRS, reasonableness is based on total compensation — including health and welfare, retirement benefits, incentive plans and other income — as compared to similar organizations. It is important to realize that all benefits and perks should be considered when the total amount of the compensation is calculated; what matters is their value, not their cost. Therefore, when the board sets executive compensation it should document its rationale for the compensation including the sources it used to find comparative salary information.

- Ideally, an organization should rely on nationally recognized compensation and salary surveys for comparison. If these are not available, it should study similar organizations and their compensation for comparable positions. Historical precedence alone for a position is not a valid comparison.
- The IRS also looks at whether the chief executive's salary was decided by an independent, objective board of directors.
- When determining increases in pay, the board should ensure that pay increases are directly linked to the chief executive and organizational performance.
- If the IRS determines that compensation is excessive, the portion of a chief executive's compensation that is deemed unreasonable by the IRS will be subject to repayment and to excise taxes.

Buying, selling, or renting property:

When dealing with property, comparable prices and fair market value provide the guidelines for financial decisions. The organization needs to show that it has examined like transactions of at least five similar organizations, and must document any deviations with explanations.

What are the possible sanctions?

If the IRS has determined that a disqualified person has engaged in an excessive benefit transaction, this person is obligated to pay a tax equal to 25% of the excess amount. In addition, she or he is required to return the excessive amount to the organization. A board member or manager who knowingly approved the transaction is fined 10% of the excess amount. If the penalty is not carried out within a specified time, a supplemental tax equal to 200% of the excess amount can be levied. These sanctions are severe enough so that ignorance or carelessness can be very costly. Any taxes imposed on the organization need to be disclosed on the Form 4720.

'Safe Harbor' mechanism

Pre-emptive behavior is the best protection and shield against these sanctions. Every organization should have a clear conflict-of-interest policy with full disclosure. This allows every board member who proves to be a disqualified person in a transaction to abstain from discussion and voting during the decision making. The organization can rely on legal counsel and expert advice to review, approve and/or determine compensation and details of financial dealings. It is important to document the decision-making process: fair market value and comparable practices in similar organizations provide an objective base value for financial transactions.

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Using the 8 Smart Things with Your Board

What is your board doing well and where does your board need to improve to handle the challenges of these turbulent times?

	Rate your board in this area using a 1-5 scale (1 being low and 5 being high)	What does our board need to do more of in this area?
Be a mission guardian		
Work more closely with your chief executive		
Get a realistic picture of your organization		
Think strategically		
Tighten your belt		
Evaluate your compensation structure		
Create a contingency plan		
Step up your fundraising		

Resource List

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