THE ARCHITECTURE OF NONPROFIT BOARDS

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Abstract

The board of directors is a governing organ whose duty is the protection of shareholder interests. Although it governs the corporation, the board of directors is usually not engaged it daily management activities. Corporate governance practice proves that usually the boards of directors are more active in times of crisis. Board of directors serve not simply as a mechanism of control over managerial activities, but also as a bridge connecting the interests of shareholders and managerial structures, especially in cases of a strict division between ownership on one side and management on the other. In many aspects, the board of nonprofit corporations are similar to the ones of big corporations, in terms of authorizations and responsibilities. But, literature suggests several differences, when it comes to size, composition and ways of conducting business between boards of for-profit and nonprofit corporations. This paper strives to provide a review of the main specifics of the boards of directors in nonprofit corporations in contrast to the boards of directors of big corporations in the contemporary world.

Keywords: corporations, corporate governance, nonprofit corporation, board of directors.

1. Introduction

The board of directors is a governing organ whose duty os the protection of shareholder interests. Although it governs the corporation, the board of directors is usually not engaged it daily management activities. Corporate governance practice proves that usually the boards of directors are more active in times of crisis.

One of the most important aspects of board functions is board authority. A few major types of board authority can be differentiated: ***Highest Authority.*** In any company the board is at the top in the chain of accountability and therefore at the top of the chain of command; ***Initial Authority;*** The board cannot abdicate its prerogatives. That means it cannot allow them to be defined or assumed by the CEO or by any of the company's employees or by any subcomponent of the board, including the chair; ***Accountable Authority.*** Because the board is the overall authority in a company, it is accountable to owners for its own performance and that of the company. And because no one has any authority unless the board has granted it, the board has control over how well all authority is exercised; ***Group Authority.*** The board possesses authority only as a group. Individual directors, including the chair, have no authority unless specifically given it by the group. In later chapters we examine how a group can perform this *first cause* role.; ***Empowering Authority.*** One of the central challenges for boards is how to *command* in such a way that management is optimally empowered and challenged at the same time. (Carver & Oliver, 2002)

The structure and processes of the boardroom have evolved to deal with three major paradoxes in the art of governance. Firstly, the board is the highest authority in the company and yet has to deal with the reality that the management controls the information required to exercise oversight. Secondly, board members are expected to provide critical judgment on the performance of the corporation, which requires directors to be personally close to management, and yet remain as objective observers of managerial behavior. Finally, while individual directors rely on each other to make good decisions, they have to be individually accountable for these decisions. The implications of the paradoxes are that excellence in corporate governance requires the board of directors to finely balance these tensions. Second, effective boards should not seek to eliminate the paradox because they are inherent in the nature of

governance but should instead use the paradoxes advantageously. The key to solving the paradoxes is to create a board structure that is independent of managerial influence, and yet responsive and sensitive to managerial concerns (Pan, 2007).

According to Charan (Charan, 2005) three main types of board of directors can be differentiated depending on their role in different periods: Ceremonial board of directors. These boards perfunctorily performed a compliance role; Liberated board of directors. Liberated directors often play to their own strengths individually, not as a collective body. They ask of their CEOs too many things, some of which are plainly minutiae or irrelevant. The limited time that these CEOs have to run their companies gets further diluted.; Progressive board of directors. Directors on a Progressive board gel into a coherent and effective group. All directors contribute to a dialogue that has lively debates, sticks to key issues while dropping tangents, and leads to consensus and closure.

The main responsibilities of the board of directors include: Represent, with a view towards advancing and protecting, the interests of shareholders and other stakeholders; Create an ethical environment; codify ethical principles and ensure that they are followed; Establish and run specialized committees as needed (e.g. audit, compensation, nomination) to provide additional support and expertise; Ensure adequacy of internal and external controls; monitor specific controls and their efficacy on an ongoing basis; Develop communications dialog/reporting links with internal control groups and serve as an independent "sounding board" and confidential counselor; Oversee the general commercial affairs of the corporation; Oversee the strategic and business performance goals of the corporation; Define strategy as related to corporate goals, business and financial targets, and financial and operating risk tolerance; Provide for appropriate crisis management planning, including business interruption, disaster recovery, and liquidity management; Develop and implement director and executive management succession plans and executive compensation plans; Consider in detail all corporate control activity (such as potential mergers, acquisitions, or buyouts) and possible defenses; Monitor the performance of management and effect changes when necessary; Ensure financial disclosure accurately represents the company's position; Communicate regularly with key shareholders and regulators (Banks, 2004).

There is no magical or ideal *size* for a board. The key question that must be faced is how many board members it takes to produce a board that has the right mix of knowledge, information, power and opportunity. The answer to this question varies considerably depending on the organization's complexity, age, and demands on board members. Size limitations that need to be taken into account. Clearly boards can be too large. Large boards end up as legislative bodies rather than as working groups. When boards are too large, it is difficult for individuals to sufficient time, it is hard to engage in true discussions, and members find it difficult to build consensus. Some researchers even suggest that larger boards are less likely to be involved in strategic decision making. Power mean dup diffused in large boards, rendering effective decision making difficult (Couger, et al., 2001).

There are many factors that influence the size of a board. The number and profile of directors will be influenced by such factors as the size, history, ownership, structure and complexity of the company. Sometimes the maximum and/or minimum number of directors is stipulated, usually in the Articles of Association. In other cases an historic merger created a composite board whose structure or size seems now to be immutable. The boards of some smaller companies seem to be structured around the number of important executive functions in the company, each of which seems to deserve a director on the board. Industry sector norms are often thought to be a deciding factor – 'What would be implied if our board's size was halved?' Some organizations, usually with over-large boards, have a number of board members purporting to represent the interests and views of various external parties, that have become enshrined by custom and practice rather than current or future relevance. Most of these apparent

restrictions can be overcome, if there is a desire and a will to do so. The overriding factor determining the board's size should be the need for well-informed decision making. Since this is the primary consideration, an effective board should usually have 4 to 10 members – 12 maximum. Surveys conducted on board size for UK companies indicate that they typically comprise six or seven directors. Companies listed on the stock exchange have somewhat larger than average boards (typically seven or eight directors), with the boards of the top few hundred companies being rather larger (Harper, 2007).

No one-board profile will fit the needs of each and every corporation. Instead, the perfect composition of the board will be a direct reflection of the corporation's unique structure and needs. In most cases, the specific framework for the board's structure will be established by the corporation's bylaws. In some circumstances, however, the structure of the board will have to change in order to accommodate new developments within the corporation, such as growth or merger. In general, a board's profile is comprised of its size, ratio of independent members, ratio of executive directors, segregation or unification of the chairperson and CEO positions, and subdivision into committees (Anand, 2008).

There are at least three main board composition dimensions. These are concerned with independence, competence and processes. Board composition is, however, broader than just finding a proper mix of outside and inside directors. The board composition question is mainly related to finding a proper balance between involvement and distance. It is a question about dependence versus independence. Board composition is also about finding proper balances of competence. Finally, board composition is about finding a group of people who can work together (Huse, 2007).

Long,Dulewicz and Gay (Long, et al., 2005) while examining the role of non-executive members of the board of directors between listed and unlisted boards, suggest that on unlisted boards non-executive directors have a greater degree of involvement in strategic development, financial monitoring, shareholder communication and overall board contribution than on listed boards, but a lesser degree of involvement in the monitoring of management, the setting of executive remuneration, the appointment and removal of executives, and succession planning. The importance of risk analysis and induction is considered high across both sectors, although board development and independence is considered less important on unlisted boards, figure 1.

Three main types of models for board composition may be differentiated:[1]Elected: Board members are chosen by a vote of the organization's stakeholders. The key here is that stakeholders, or their representatives, directly select board members; Appointed: Board members are chosen by some other entity; a parent board or a sponsoring organization or governmental agency. Here, control of the board's composition rests outside the organization; Self-selected: The board nominates and chooses its own members (Pointer & Olikoff, 2002).

[1] Dennis D. Pointer, James E. Orlikoff:, Jossey-Bass, Danvers, 2002,p.98

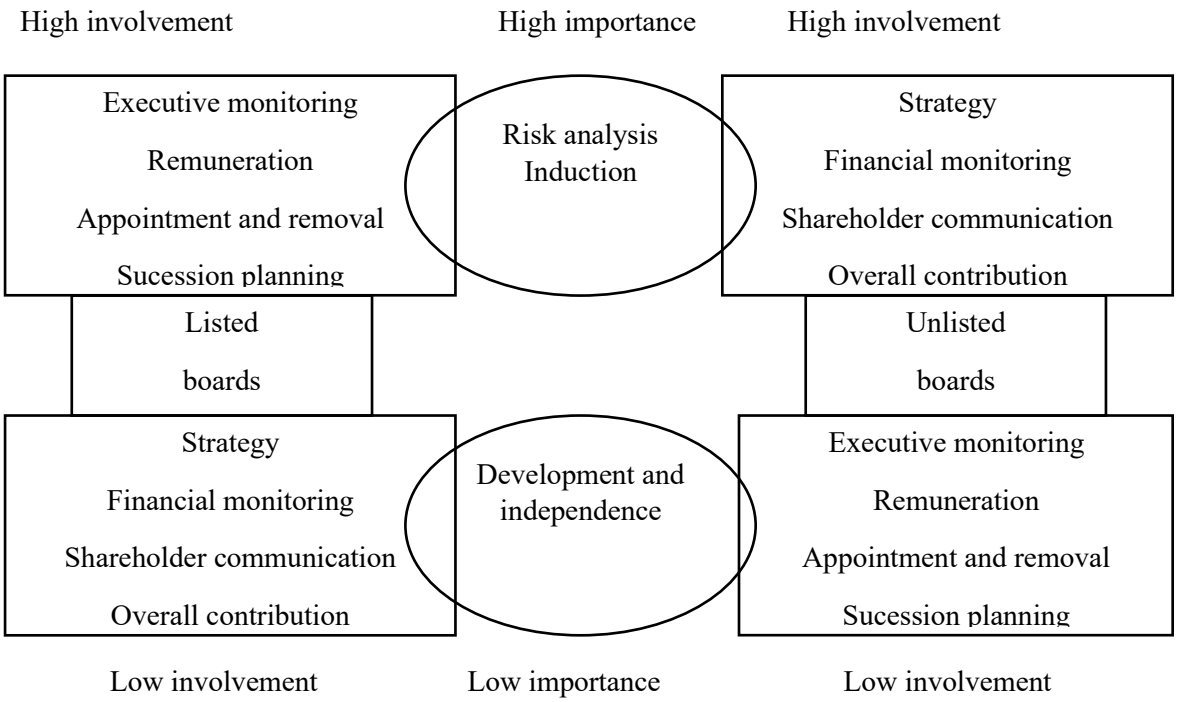

Figure 1. The role of non-executive board members (Long, et al., 2005)

There are three main types of characteristics of the members of the board of directors as presented in figure 2.

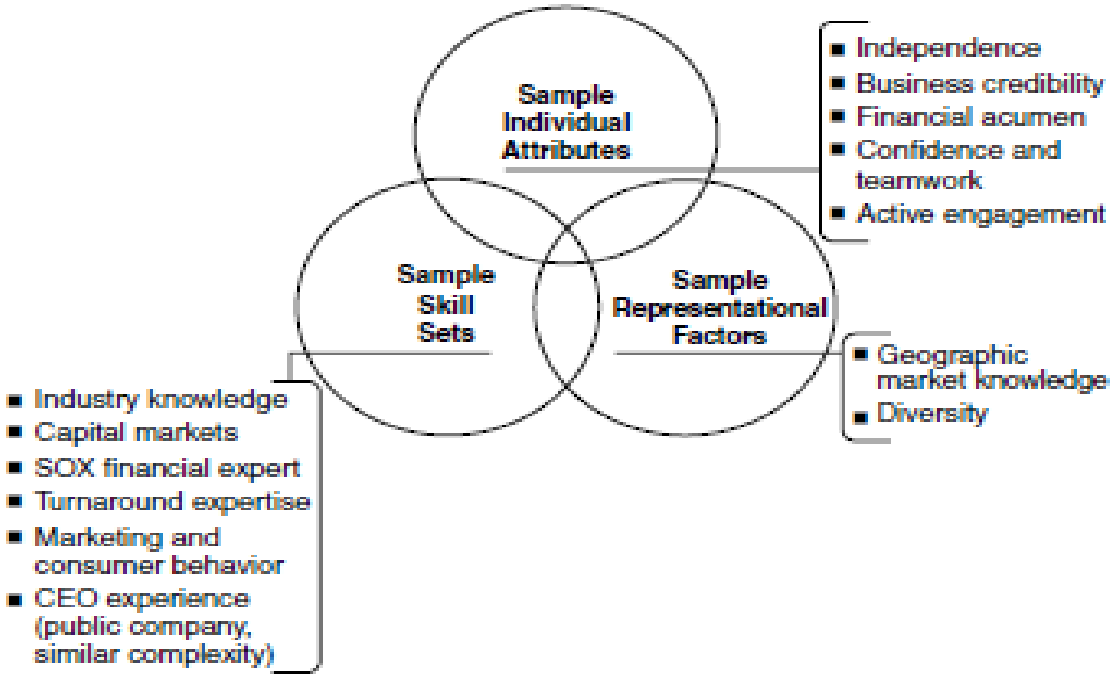

Figure 2. Characteristics of the members of the board of directors

In general board committees should function according to some basic principles such as (Carver & Oliver, 2002):

- Function as part of and under the control of the board, not management,
- Can have no authority that does not come from the board,

- Can have no authority or accountability that is also delegated to management,
- Cannot relieve the full board of its ultimate accountability for everything,
- Cannot have the authority to instruct management,
- Are always meant to help the board with some part of the governance job,
- Are never meant to help or advise management,
- Are charged to produce products (values added), not to engage in activities,
- Have authority to use money or support personnel only if that is granted by the board.

The most common types of board committees are: Revision, Remuneration, Executive, Nomination, Finance
Benefition, Public relations, Corporate ethics and Science and technology committee.
The audit committee must be responsible for the appointment, compensation and oversight of the work of the independent auditor. Then, the committee must establish procedures for receiving confidential, anonymous submissions by employees regarding questionable accounting or auditing matters (i.e., formally establish whistleblower provisions in the company). The committee must have authority to engage independent advisers as necessary and be provided with adequate funding. The audit committee must pre-approve the rendering of non-audit services by the independent auditor. This approval can be given on a general basis as part of approval of the engagement. Independent auditors are to report to the audit committee on critical accounting policies and practices of the company, on alternative treatments within GAAP discussed with management and on written communications such as management letters and schedules of unexplained variances (Pan, 2007).
Perhaps one of the most important characteristics of an effective audit committee is its ability to deal effectively with other oversight functions serving the organization, such as the internal and external auditors, while at the same time maintaining the collegiality and cooperative relationships that are necessary for effective board membership. Audit committee members require several important personal characteristics in addition to those that are necessary to function as effective members of the board of directors. All members of the audit committee must be independent of the management of the organization in appearance as well as in fact so they can effectively accomplish the audit committee's oversight mission, with its many responsibilities. More important, audit committee members must act with independence and objectivity (Veschoor, 2008).
The compensation committee of the board should establish a compensation philosophy, set performance goals, ensure that pay is in line with performance, and obtain necessary outside counsel and advice. The purpose of the compensation committee is to review and report to the board on compensation and personnel policies, programs, and plans, including management and succession plans; and to approve employee compensation and benefit programs. The top-performing companies' proxy statements provided full disclosure in the compensation committee reports and executive pay sections. This is an indication of a well-organized and well-functioning compensation committee. As consultants, we recommend that the compensation committee reduce the multitude of pay issues, other related initiatives, and noise to a few initiatives and communicate this information to shareholders and potential investors in a clear, concise, and unequivocal manner (Reda, 2002).
The function of the compensation committee is to evaluate managerial performance, and set the appropriate reward and incentive structures. The activity of monitoring not only includes assessing the outcome of implemented decisions, but also overseeing the integrity of the assessment process. The work of this committee has become strategic because the right compensation structure ensures that the management is focused on the appropriate performance targets and therefore strongly influences the strategic plans they formulate for the firm. The best way to do so is to create incentives that align the interests of the Chief Executive Officer with those of the shareholders (Pan, 2007).

Tyson and Bournois (Tyson & Bournois, 2005) introduce four types of remuneration committees: pedestrian, tense, self-serving and adaptive as shown in figure 3.

VALUES / PERSPECTIVE	Internal	External
Historical	PEDESTRIAN	TENSE
Contemporary	SELF-SERVING	ADAPTIVE

Figure.3. Matrix of remuneration committee types (Tyson & Bournois, 2005)

Pedestrian describes the remuneration committee that values its traditional approach using history and precedents in its internal process management, and favours well-tried and tested approaches to arranging directors' rewards. Turning to the next category, this is exemplified by those companies whose remuneration committees have a balanced membership, with individuals of public note and prestige. They bring experience and values, which mean that the committee is not rooted in its own, or the company's, old values. Despite this, the committee is traditional and precedent based in its reward mechanisms and its reward decisions. At the end of the process, the committee operates in self-serving mode. There are likely to be more remuneration committees fitting the description 'Tense' than there would have been several years ago. The increased public and political interest in top-level remuneration has resulted in formal reporting requirements that place an emphasis on market comparisons, which, in turn, draws committees towards the External classification on the Perspective axis. The remuneration committees that have a contemporary set of values and norms and are orientated towards external reference points of markets and comparators can be seen as those embracing the most recent model of remuneration committee operation. These committees can be described as Adaptive, as they move or have moved to adopt what is conventionally regarded as 'best practice (Tyson & Bournois, 2005).

The nomination committee, concerned with identifying and selecting new non-executive directors, meets less frequently than the audit and remuneration committees. Its task is to ensure that the board has an appropriate mix of skills and experience and that succession plans for retiring directors are organized well in advance. A tricky issue is the degree of influence that should be wielded by the Chief Executive in the appointment of new directors. The Combined Code states that new directors should be independent, having no previous business connection with other members of the board, and most companies go to great lengths to avoid any hint of cronyism in their appointments. Yet there is still a tendency to go for candidates who will fit in with the established culture of the board, and to steer clear of people who may be thought to be too aggressive or in some sense too awkward in their approach (Rushton, Ken (Ed), 2008) .

2. Specifics of nonprofit boards

The complexity of the not-for-profit sector is what makes it interesting. Here are some of the common reasons for its complexity: Income sources are usually diverse and all require active management; Different parts of the *Income Tax Assessment Act* apply to the not-forprofit sector compared with individuals or businesses.; Tackling social, educational, cultural, health and environmental problems is difficult work and often involves many stakeholders, including consumers and government; Salaries are usually below other sectors so staff expect other nonfinancial rewards for their work; Board members are often not paid for their time or, if they are, it's usually a modest amount. Board and staff roles can easily become blurred in challenging times, causing conflict; There is pressure from funders on not-for-profits for innovation or at least continual improvement; The public policy environment changes each time there is change in state or federal government, and sometimes even if there is just a change of minister!; A not-for-profit is established to achieve certain objectives (Brown, 2010).

Every organization needs board members who possess the appropriate experience and expertise to provide advice regarding the challenges and opportunities the board itself faces. Typically, this expertise is evaluated in the context of a board member's primary profession—such as a lawyer, physician, engineer, and so on. However, for an organization to function efficiently and effectively in the 21st century, the selection of board members for a non-profit organization should also take into account certain qualitative characteristics, such as the capacity for critical thinking, interpersonal skills, a willingness to work as part of a team, and the ability to examine processes and developments from a strategic perspective (Fram, 2016).

One of the first things that strike one about nonprofit boards is their average size. Nonprofit boards are much larger than is typical for the board of a for-profit corporation. The corporate board averages ten to fifteen trustees; the nonprofit board generally consists of thirty to fifty members, even in rather modest-sized corporations…The composition of the nonprofit board also differs from that of the for-profit in several ways. Nonprofit boards typically consist entirely of outsiders, nonemployees of the organization. The for-profit board generally combines insiders and outsiders…Nonprofit boards typically include representatives from the public sector, other nonprofits, and community representatives, as well as the more typical lawyers and business people. These boards, too, contain knowledge and expertise, but it is of a more far-ranging sort (Oster, 1995).

The boards of not for profit corporations have five main responsibilities (Zimmerman, 2004):

- To ensure sound planning and policies (write the mission and vision statements; make sure that programs accord with the mission).
- To ensure good management (evaluate, hire, and if necessary fire the executive director; review personnel policies).
- To ensure sound resources and financial dealings (assist with fundraising and public relations; guarantee financial accountability).
- To ensure compliance with legal requirements (file required papers and act as a trustee/fiduciary; comply with bylaws).
- To ensure good governance (conduct a periodic board self-evaluation; keep minutes; recruit new members; update bylaws as appropriate).

Besides the above mentioned, the list of board responsibilities also includes (Board Source, 2007):

- Determine the organization's mission and purpose. It is the board's responsibility to create and review a statement of mission and purpose that articulates the organization's goals, means, and primary constituents served.
- Select the chief executive. Boards must reach consensus on

- The chief executive's responsibilities and undertake a careful search-and-selection process to find the most qualified person for the job.
- Provide proper financial oversight. The board may assist in developing the annual budget, regularly review financial statements, and ensure that proper financial controls are in place.
- Ensure adequate resources. One of the board's foremost responsibilities is to ensure that adequate financial resources exist for the organization to fulfill its mission.
- Ensure legal and ethical integrity and maintain accountability. The board is ultimately responsible for seeing that legal standards and ethical norms are respected.
- Ensure effective organizational planning. Boards must actively
- Participate in an overall planning process and assist in implementing and monitoring the plan's goals.
- Recruit and orient new board members and assess board performance. All boards have a responsibility to articulate prerequisites for candidates, orient new members, and periodically and comprehensively evaluate their own performance.
- Enhance the organization's public standing. The board should clearly articulate to the public the organization's mission, accomplishments, and goals and garner support from the community.
- Determine, monitor, and strengthen the organization's programs and services. The board must determine which programs are consistent with the organization's mission and monitor their effectiveness.
- Support the chief executive and assess his or her performance. The board should ensure that the chief executive has the moral and professional support he or she needs to further the goals of the organization.

One of the main responsibilities of not for profit boards is to ensue finance for the organization. Having this in mind the following aspects must be observed: All funding applications must be submitted to the board in a timely fashion before being submitted to funding sources; Each fundraising special event should be approved by the board. The proposal should include a budget for each event, an outline of the tasks to be performed, and a detailed timetable; The responsibilities of the board members for fundraising should be spelled out in writing. This might include a requirement to contribute to an annual financial campaign, a statement that attendance at all special events is required, and a statement that each board member must be an active participant in planning at least one fundraising program each year ((Sand, 2005).

The members of the board of directors of not for profit corporations have three main roles as presented in figure 4.

1. Governance Hat (only hat that carries legal authority to govern)	► Worn only when in a properly called board or committee meeting with a quorum ► Decisions made only when part of the group wearing this hat ► CEO is accountable only to governing policies set by the board
2. Volunteer Hat (this hat carries no legal authority)	► Goes on when leaving a board or committee meeting ► Worn when advising the CEO ► Worn when fundraising ► Worn when helping staff (alone or in a group) and often under the supervision of the staff
3. Implementer Hat (carries limited authority, but is seldom worn in most boards)	► Seldom worn because staff usually implement board policies ► But worn when a board resolution or the CEO gives a board member authority to implement some board action ► Hat is removed when task is done

Figure.4. Roles of nonprofit board members (Laughin & Adringa, 2007)

3. Conclusions

Nonprofit boards are not the same as boards of directors in for-profit corporations. While in corporations the main idea behind all boards processes is the protection of shareholder interests and the creation of added value for them, this is not the case for nonprofit boards. In nonprofit boards the situation is totally different. There are no owners, but there are assets held within a trust. This results with a board being responsible to a larger stakeholder base, with donors and beneficiaries being the two "main" categories among them. As already mentioned, tax regulations, boards size, structure and way of functioning are also among the factors differentiating nonprofit boards from the boards of directors of for-profit corporations.

Therefore, it is obvious that nonprofit boards are not simply boards of directors with the "profit" notion deleted or excluded from the equation. They are so much more. Their missions are meant to be "constant" and to have a larger social impact. These boards are not comprised of "recruited professions" but rather from volunteers that should remain committed to the mission mainly due to their subjective reasons. But, this very fact can also prove to be a weak point since being enthusiastic about a cause does not necessarily mean that one is also committed in terms of active as contrary to passive participation in board discussions and decision making.

Decision making itself is usually consultative and, in many cases, requires achieving a consensus among board members is if not required that at least preferred. Such an approach from a business point of view might be considered as a wrong approach since it might complicate and prolong decision making. But, perhaps if board members are truly committed and well prepared for meetings this should not be viewed as a burdening matter in the case of

nonprofit boards. On the other hand, a dilemma remains: How can you motivate people that receive no remuneration to be committed over longer periods of time.
In conclusion, nonprofit boards are specific by nature because they need to govern organizations without classical owners and ownership, organizations that in some if not most cases can not get rid of the founder's syndrome, organizations with usually weaker financial oversight, and in which role confusion is the main governing problem.

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