Advice if joining a non-profit board

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Issues to Consider

- What to Ask Before You Join
- Finance and Audit Policies
- Investment Management
- Executive Compensation
What to Ask Before You Join

- Determine if the firm has directors & officers (d&o) liability insurance
- Analyze the financial statements (audited and Form 990)
- Ask for the minutes of the audit committee
- Ask the CPA audit firm about its audit findings, opinion of the internal controls and health of organization
- Examine compensation and benefit arrangements
- Examine the investments and investment policy
- Ask for financial reports (and written explanation) in advance of the meeting
Finance and Audit Guidelines

- Role of Finance/Audit Committee
- Audits
- Briefing Books
- Cash Management
Finance & Audit Committee

Charge of the Committee:

- To advise and consult with Treasurer on issues of financial management and planning
- To serve as the audit committee to whom the external auditors are to report
- To select and hire external auditors
- To set policy for investment of excess funds

Membership:

- “Independent” directors
- Financial and accounting experience
Audits

- To have an annual financial audit conducted a CPA firm (if size and complexity of firm warrant it)
- To employ the CPA firm, in general, for three years but no more than 5 years
- CPA firm to be selected and hired by Board
- CPA to report first and foremost to the Board (particularly Finance Committee)
Master Briefing Book: Permanent Book

- Description of Duties and Responsibilities of Finance Committee, Audit and Investment Committees
- Annual Calendar of meetings and key agenda items Summary of Key Assets of the Organization (Facilities, Fund Inc.) including legal relationships.
- Summary of Investment Portfolio, investment policy and guidelines, key holdings, historical performance
- Summary of Key Legal Contracts, particularly financial
- Summary of Other LT commitments/Obligations
- 3 latest audits
- 3 latest 990s
- Summary Performance of Past 10 years of organization, including key operating ratios
- Strategic Plan
- Approved Budget for the year
- Summary Performance of Budget vs. Actual USA for 3 years
- Description of the Annual Budgeting Process including performance assessment (should tie to calendar)
- Organizational Chart: Key staff members and board members, including contact information

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Master Briefing Book: Annual Budget

- Strategic Plan (section that is pertinent to this time period)
- Key programmatic and financial objectives and outcomes ("targets") for the year, which should flow from the strategic plan, e.g. # of new Ys, # of members, # of programs
- Historic programmatic and financial objectives and outcomes (actual for prior years and anticipated vs. budgeted for current year).
- Conversion of historic information into costs per unit.
- Annual Budget Projections, including:
  - assumptions (macroeconomic and organization-specific)
  - based on outcomes * costs per unit
  - projected operating budget, capital budget, combined income statement, balance sheet, and cash flow, with narrative
  - For each major capital budget item, have a forecasted cash flow with how the project fits into the strategic plan, rates of return, different scenario
  - Identification of the key uncertainties and risks associated with annual budget, perhaps including some "what if scenarios"
- Anticipated changes in budgeting process, staffing, reporting systems, computer systems, etc. needed to accomplish the budget for the year.
- The budget document should be circulated in advance with narrative attached to permit time to read and ask questions in advance of meeting.

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Master Briefing Book: Quarterly Book

- Agenda
- Minutes
- Summary of key events and trends, including
  - Changes in key assets, staffing, financial and legal obligations
  - Changes in assumptions for the year
  - Changes in performance for the year
- Restatement of key “targets” for the year
- Financial Report
  - Comparison of the quarter budget and year-to-date to budget with:
    - both programmatic and financial targets for the year and performance relative to it.
    - narrative description indicating the reasons for variances and expectations for whether this is a timing issue or change in expectation.
  - Summary of revised expectations for the following quarter, year, and long term (numerical and narrative)
- Investment Report
  - Recent Performance in context of longer term performance
- Section on other key agenda items.

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Cash Management

- To maintain cash funds only in banks or brokerage firms that have a credit rating of AAA, AA or A
- To maintain cash funds only in accounts that have full FDIC coverage. As the FDIC coverage is presently limited to $100,000 per bank, balances at an one bank is to be limited to $100,000 or under
- For the checking accounts, an assessment should be conducted to determine if it would be better to keep balances in:
  - an interest-bearing NOW account and pay the fees associated with type of account, or
  - a non-interest bearing account and with lower fees
- The excess cash balances should be kept in interest-bearing accounts or CDs, potentially setting up a sweep account arrangement that keeps all current balances in interest-bearing accounts
Investment Management

- Goals & Objectives
- Identification of Resources & Capabilities
- Management Procedures
- Time Frames
- Risk Tolerance
Investment Policy

- For the Board to set, staff to execute

Considerations

- Risk
- Expected return
- Diversification
- Flexibility/Liquidity
- Convenience to Manage
Modern Portfolio Theory

EXHIBIT 3.1. Efficient Frontier

EXHIBIT 3.6. Portfolio Theory Reduces Risk—Diversification—Elimination of Specific Risk

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# Types of Investments

<table>
<thead>
<tr>
<th>Securities</th>
<th>Typical Minimum Maturity Period</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiable order of withdrawal*</td>
<td>Immediate</td>
<td>Low risk, especially if institution is federally insured</td>
</tr>
<tr>
<td>Money market mutual fund</td>
<td>Immediate</td>
<td>Low risk, especially if portfolio is weighted toward U.S. Treasury paper</td>
</tr>
<tr>
<td>Repurchase agreements</td>
<td>1–90 days</td>
<td>Risk depends on security backing agreement</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>20 days or more</td>
<td>Risk depends on issuing corporation</td>
</tr>
<tr>
<td>Certificate of deposit</td>
<td>90 days</td>
<td>Low risk, especially if institution is federally insured</td>
</tr>
<tr>
<td>U.S. Treasury bills</td>
<td>90 days</td>
<td>Low risk</td>
</tr>
<tr>
<td>Negotiable certificates of deposit</td>
<td>90 days</td>
<td>Low risk, but requires large initial amount of $100,000</td>
</tr>
<tr>
<td>U.S. Treasury notes</td>
<td>3 years</td>
<td>Low risk, but long holding period</td>
</tr>
<tr>
<td>U.S. Treasury bonds</td>
<td>30 years</td>
<td>Low risk, but long holding period</td>
</tr>
<tr>
<td>State and local government bonds</td>
<td>30 years</td>
<td>Varying risk depending on issuer; long waiting period</td>
</tr>
<tr>
<td>Mutual funds (other than money market)</td>
<td>Immediate</td>
<td>Risk depends on investment philosophy of fund</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>20 years</td>
<td>Risk depends on issue</td>
</tr>
<tr>
<td>Common stocks</td>
<td>Immediate</td>
<td>Wide fluctuations</td>
</tr>
<tr>
<td>Preferred stocks</td>
<td>Immediate</td>
<td>Fluctuate like bonds; risk of dividend default</td>
</tr>
<tr>
<td>Tax-sheltering partnerships</td>
<td>Indefinite</td>
<td>Risky and redemption depends on terms set in contract; early redemption will lead to losses</td>
</tr>
<tr>
<td>Guaranteed investment contracts</td>
<td>3–5 years</td>
<td>Fixed interest; should be considered long term</td>
</tr>
</tbody>
</table>

*By law, available only to individuals and nonprofits.
Asset Mix By Investment Horizons

1 Year
- T-Bills: 10%
- 6 Mth CDs: 25%
- Money Market: 65%

2-3 Years
- T-Bills: 40%
- 6 Mth CDs: 20%
- Money Market: 40%

Over 10 Years
- Bonds: 45%
- Equity: 45%
- Money Market: 10%
Investment Guidelines

- To maintain a conservative asset mix of cash and investments, concentrated in T-bills, money markets and CDs
- Gifts of stock
  - In most cases, sell immediately
- To give any funds to a money manager, only after the Audit and Finance Committee have developed guidelines for:
  - approving and monitoring money managers and
  - diversification, risk, and expected returns for any investments the money managers are to make
Challenges of Nonprofit Compensation

- Attracting, retaining and motivating qualified employees
- While complying with IRS regulations that limit prohibit:
  - excessive compensation
  - violating the non-distribution constraint
Prior Literature

- **Comparison to for-profits:**
  - Find: Nonprofits pay less for comparable work

- **Labor donations:**
  - Find: Nonprofit workers prefer altruistic and other non-pecuniary benefits to monetary rewards
  - Rose-Ackerman 1986, Preston 1989

- **Screening device:**
  - Find: Lower pay screens out managers that are strictly profit-oriented
  - Young 1977, Hansmann 1980
IRS Regs: Excessive Compensation

- Excessive if it “exceeds what is reasonable under all the circumstances.”

- Reasonable “if it is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances.”

- During sample, only sanction was revocation of tax-exemption

- Subsequently, IRS permitted to impose an intermediate sanction in form of excise tax
IRS Regs: Non-distribution Constraint

“Net earnings, if any, must be retained and devoted in their entirety to financing further production of services that the organization was formed to provide.” (Hansmann)

Interpreted often as limiting ability to offer many forms of incentive compensation

During sample, a possible sanction was revocation of tax-exemption