

2009 National Board Governance Survey for Not-for-Profit Organizations

Seventh annual



Grant Thornton LLP's Not-for-Profit Cabinet

Grant Thornton's Not-for-Profit professionals are at the forefront of assisting clients with regulatory, tax, accounting, business and governance developments in the not-for-profit sector. We are committed to supporting the not-for-profit sector as it faces the challenges of these difficult economic times and increased government oversight. If you have any questions regarding this survey or any other matter, please feel free to contact your local Grant Thornton partner or manager or any of the following professionals who contributed to this survey.

Frank Kurre
National Managing Partner
Not-for-Profit and
Higher Education Practices
T 212.542.9530
E Frank.Kurre@gt.com

Mark Oster
Principal-in-Charge
National Not-for-Profit
Advisory Services Practice
T 212.542.9770
E Mark.Oster@gt.com

Daniel Romano
Partner-in-Charge
Not-for-Profit Tax Practice
T 212.542.9609
E Daniel.Romano@gt.com

Frank Jakosz
Partner-in-Charge
Midwest Not-for-Profit and
Higher Education Practices
T 312.602.8652
E Frank.Jakosz@gt.com

Ben Kohnle
Partner-in-Charge
Southwest Not-for-Profit and
Higher Education Practices
T 214.561.2260
E Ben.Kohnle@gt.com

Terri Albertson
Partner-in-Charge
Northeast Not-for-Profit
and Higher Education Practices
T 215.656.3068
E Terri.Albertson@gt.com

Charles Violand
Partner-in-Charge
Southeast Not-for-Profit
and Higher Education Practices
T 703.847.7626
E Charles.Violand@gt.com

Rick Wentzel
Partner-in-Charge
West Not-for-Profit and
Higher Education Practices
T 213.688.1730
E Rick.Wentzel@gt.com

Kim McCormick
Partner-in-Charge
Greater Bay Area Not-for-Profit
and Higher Education Practices
T 408.346.4324
E Kim.McCormick@gt.com

Dennis Morrone
Partner-in-Charge
New Jersey Not-for-Profit and
Higher Education Practices
T 732.516.5582
E Dennis.Morrone@gt.com

Nancy Murphy
Tax Principal
National Not-for-Profit Tax Office
T 703.637.2699
E Nancy.Murphy@gt.com

Larry Ladd
National Director
Higher Education Practice
T 617.848.4801
E Larry.Ladd@gt.com

Contents

- 1 Executive summary
- 2 The economic downturn
- 4 Training
- 7 Communication
- 9 The role and structure of the board
- 10 The audit committee
- 12 Governance
- 16 About the survey
- 17 About Grant Thornton LLP

Executive summary

By nearly all accounts, 2009 was a challenging year for the not-for-profit sector. Declining revenues due to a lingering recession, growing governance and disclosure expectations, and closer scrutiny from regulators and donors sounded — for many — a jarring wake-up call. The vast majority of organizations responded accordingly, cutting costs, seeking new revenue streams, reducing endowment spending, enhancing governance practices and reassessing their strategic plans, among many other changes in 2009.

Business environment

In the face of declining revenues from donors, granting agencies, federal and state governments, and underwater endowments, nearly all organizations felt the squeeze. Consequently, not-for-profit organizations were very focused on trimming expenses, particularly general and administrative expenses and noncore programs. Nearly nine in 10 (87%) respondents reduced expenses, while more than half (54%) reduced personnel. Nearly half (49%) delayed capital projects. At the same time, savvy organizations also increased fundraising efforts to make up for diminished revenues.

Focus on governance

There was a sharply increased focus on governance and transparency for not-for-profit organizations in 2009. As a result of the new IRS Form 990 requirements, not-for-profit organizations are now required to disclose a great deal of information concerning their governance policies, practices and procedures. This has led many organizations to review and reassess their approach to governance, with an eye toward creating greater transparency. Organizations made a number of policy changes in 2009, implementing procedures such as requiring the board and/or one of their committees to review the Form 990 before it is filed with the IRS (55% of boards). Boards also adopted investment (39%), record-retention (32%) and whistleblower (26%) policies, among others.

Rethinking plans

Even organizations with well-thought-out strategic plans are finding that in today's environment, their plans may no longer match their situation. More than half (56%) of survey respondents revised their strategic plans in light of the economic downturn.

Scrutiny of executive compensation

IRS inquiries into compensation practices, new Form 990 disclosure requirements and highly publicized scandals related to excessive compensation have raised the level of scrutiny concerning executive pay and benefits. Nearly three-quarters (73%) of respondent organizations now have formal policies in place to review executive compensation.

Attention to investments

A volatile market and staggering losses for a number of organizations led nearly six in 10 (58%) to rebalance their investment portfolios. Almost four in 10 (39%) respondents also made changes to their investment policies in 2009, up from 27% in 2008. Many organizations have lessened their positions in alternative investments and have maintained higher cash positions than in previous years.



The economic downturn

The economic downturn has certainly taken its toll on the not-for-profit sector. Many not-for-profit organizations are experiencing declining revenues from donors, granting agencies, federal and state governments, and endowments. At the same time, many organizations face operating deficits and greater challenges obtaining credit for short-term liquidity and capital needs, while experiencing increased demand for services. Organizations have responded in numerous ways, including cutting costs, increasing fundraising efforts and revisiting strategic plans. Nearly nine in 10 (87%) reported that they have reduced expenses.

Cost cutting

Not-for-profit organizations were largely focused on cutting administrative costs: Two-thirds (66%) of respondents said that cuts were administrative in nature, while approximately one-third (31%) cited cuts in programs. A small percentage (3%) pointed to cuts in technology spending. One reason for the heavy cutting in the administrative area is that these expenses are often not reimbursable under foundation or government contracts, while many program expenses are reimbursable. Also, some watchdog agencies evaluate the ratio of program costs to the total actual expenses, so organizations are focused on preserving their program-expense ratios at as high a level as possible. Most organizations have tried not to cut back on their core services, but 40% have had to reduce or eliminate certain noncore programs. Organizations have been particularly focused on cutting nonsalary costs such as travel, events and publications and have made personnel and programmatic cuts only when absolutely necessary. However, more than half (54%) of respondents indicated that they had reduced the number of personnel in 2009.

“A number of organizations are defining their mission with greater focus and preserving only those programs that are the most essential to that mission,” comments Larry Ladd, national director of Grant Thornton’s Higher Education practice.

What new issues has the recession created for your organization to address?*



*Respondents were able to select more than one answer.

Strategic plans

Even organizations with carefully crafted strategic plans are finding that in today’s environment, their plans need to be revised and updated. More than half (56%) have revisited their strategic plans in light of the recession. Perhaps more surprising is that 44% have not. One explanation might be that some of these organizations have been too busy reacting to the crisis on a day-to-day basis to take the time to step back and reconsider their plans at a higher level.

“While strategic planning is always important, it becomes absolutely essential during difficult times,” says Mark Oster, principal-in-charge of Grant Thornton’s national Not-for-Profit Advisory Services practice. “While organizations initially focused on responding to the economic issues, we expect to see attention shifting toward revisiting their strategic plans and priorities in 2010.”

Frank Jakosz, partner-in-charge of Grant Thornton’s Midwest Not-for-Profit and Higher Education practices, explains: “We are finding that even organizations that are not revisiting their longer-term three- to five-year strategies are adjusting their tactics. For example, they are changing their annual activities, rethinking the timing of campaigns and forgoing certain events.”

Another response was to re-examine investment portfolios. Some boards, believing that their investment committees and/or investment managers had not performed effectively, became much more focused on their investment portfolios and policies. Nearly six in 10 (58%) respondents said they had rebalanced their investments.

“Many organizations have reduced their positions in alternative investments,” notes Frank Kurre, national managing partner of Grant Thornton’s Not-for-Profit and Higher Education practices. “Many organizations are maintaining much higher cash positions than in previous years. Unfortunately, although the market improved in the second half of calendar 2009, many organizations did not fully benefit, since they had shifted out of equities into more conservative cash and fixed-income positions.”

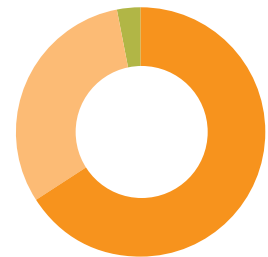
Fundraising

It is important to note that while cost cutting is critical at this time, it can only go so far. It is at least as important for organizations to seek new and additional sources of revenue. Nearly six in 10 (59%) are paying more attention to fundraising, which is especially critical now.

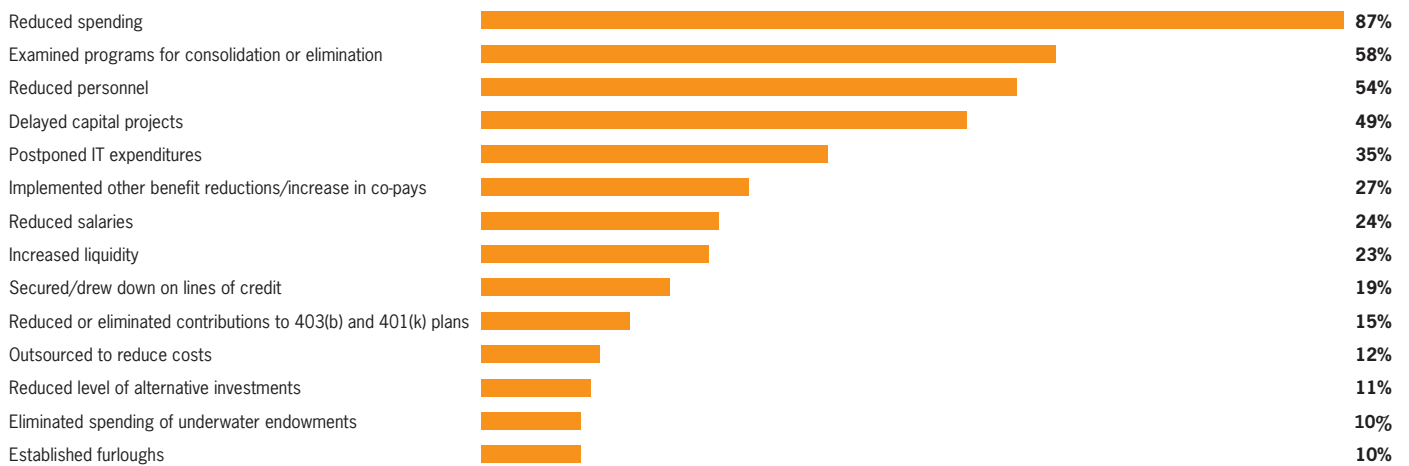
“If your development people have thrown up their hands and told you there is nothing more they can do,” says Kurre, “I’d argue that you may have the wrong development people. Now is the time for organizations to pay more attention to fundraising, spending more time with donors and developing and strengthening those relationships.”

If you have reduced expenses, are they:

- Administrative 66%
- Programmatic 31%
- Technology 3%



What actions did your organization take to address the economic crisis?*



*Respondents were able to select more than one answer.

How has your organization's agenda changed over the last year?*



*Respondents were able to select more than one answer.

Training

Providing appropriate training to board members is critical to ensuring a board’s long term effectiveness. Not-for-profit organizations became somewhat more rigorous in their approach to training in 2009, with many offering new board member orientation, continuing education for existing board members, and sometimes annual retreats for the entire board.

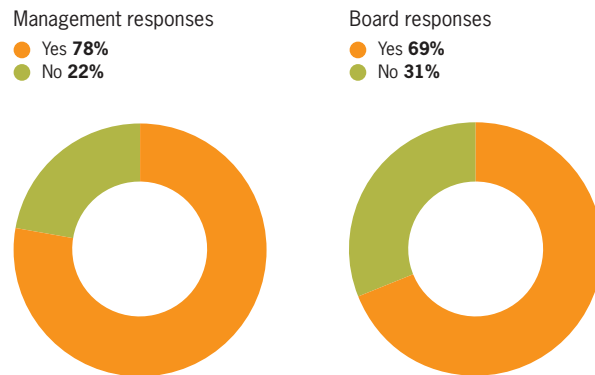
“The education of board members is essential to effective stewardship,” advises Terri Albertson, partner-in-charge of Grant Thornton’s Northeast Not-for-Profit and Higher Education practices. “On a regular basis, time should be set aside to cover important topics for board members, such as the predicted effects of pending legislation, tips for understanding financial statements, and effective fundraising techniques.”

Board orientation

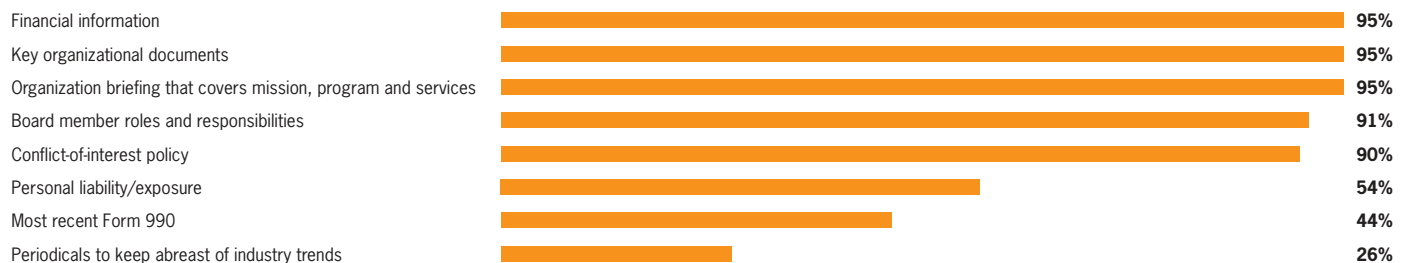
Three-quarters (75%) of organizations held orientation sessions for new board members, covering topics such as financial information; key organizational documents, including review of bylaws, articles of incorporation, history of the organization and the strategic plan; and an overview of the organization’s mission, program and services. The vast majority (91%) also covered board member roles and responsibilities, and conflict-of-interest policies. More than half (54%) discussed personal liability/exposure, and more than four in 10 (44%) focused on the new Form 990 as part of their orientation sessions.

Interestingly, among those surveyed, board members’ perceptions of whether they had been given a thorough orientation to the organization were somewhat different from those of survey participants who were not board members. More than three-quarters (78%) of management respondents reported that the board receives a thorough orientation, while closer to two-thirds (69%) of board member respondents agreed with this statement.

Do new board members receive a thorough orientation to your organization, the board’s role, and relevant industry trends that impact your organization?



What does the orientation session include?*



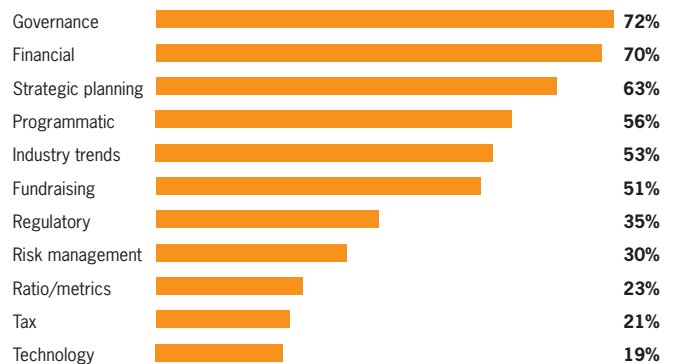
*Respondents were able to select more than one answer.

This finding suggests that some not-for-profit organizations could do a better job of orienting their board members, particularly with regard to Form 990, personal liability and other topics. This formal orientation should also cover such topics as how the board functions, management duties vs. board duties, indemnification and insurance, board committees, information flow, delegation, and authority.

Ongoing training

When it comes to ongoing training, only about half (53%) of survey respondents reported that their organizations offer the board focused training on key organizational issues and briefings on key industry trends throughout the year. The most frequent topics covered are governance (72%), financial (70%), strategic planning (63%) and programmatic (56%). At the same time, only half (51%) offer training on fundraising, while slightly more than one-third (35%) provide education on regulatory issues. A mere three in 10 (30%) organizations cover risk management as part of their ongoing board training.

Which of the following types of training topics do you cover?*



*Respondents were able to select more than one answer.

Best practices in board orientation

No matter how well-qualified your new board members are, it will take time to get them up to speed and comfortable as members and leaders of your organization. Investing in board orientation helps new members hit the ground running and gain comfort in voicing their opinions and becoming stewards of your organization. The orientation process is a four-phase process that includes recruitment, orientation, feedback and ongoing development.

In the recruitment phase, send prospective board members an overview of your organization and board. The overview should include the mission, strategic plan, programs and services, financial data and other background information, as well as a list of expectations of board members related to number of meetings, committee assignments, length of board term and time commitment.

The next critical step is orientation. Before the first board meeting, schedule a meeting between the new board members and key individuals in the organization. Provide a detailed board member manual, which should include bylaws and articles of incorporation, a thorough description of programs and services, the current budget, last audited financial statements, a list of board members and their addresses, lists of committee and staff assignments, minutes for the previous year, and the organization's strategic plan. Also, provide the new board member with a tour of your organization, and discuss potential committee assignments. There should be a synergy between the interests, skills and preferences of the individual board member and the requirements and challenges of the committee he or she joins. At their first meeting, introduce new members to all current board members and staff. Consider assigning a mentor board member to work with the new board member for the first several months.

The feedback phase is intended to solicit timely responses regarding what worked well and what could be improved in the future to ensure board members are receiving the right information and the maximum benefit. The board member should submit a formal written document; in addition, the board chair should interview the board member face to face.

Finally, in the ongoing development phase, boards should consider having an off-site annual retreat to continually enhance board performance. In addition, consider having board members complete annual self-assessments of their individual effectiveness.

Understanding financial statements

Board members and, in particular, finance and audit committee members need to read, understand and interpret the financial statements of not-for-profit organizations in order to exercise their responsibilities. Fortunately, more than 83% of survey respondents indicated that they did so. The increase in CPAs and other finance professionals on boards almost certainly helps boost this statistic. However, nearly two out of 10 (17%) respondents reported that board members lack a robust understanding of the organization's financial statements.

This finding signals that there is still room for improvement. Board members could benefit from further instruction in reading financial statements, especially given that much of the information a prudent board requires is of a financial nature. For example, board members are likely to be called on to review current operating results, comparisons of actual spending versus budget, a statement of financial position, and the CEO's and CFO's report. Board members may also need to review quarterly income projections, cash and working capital forecasts, capital expenditure plans, employee pension plan information and other financial data.

Survey respondents felt their boards could use further training primarily in two areas: responding to issues raised within the financial statements (57%) and understanding the fundamentals of not-for-profit accounting and financial reporting (51%). This finding is not surprising given that many board members, even those with finance and accounting backgrounds, are accustomed to accounting and reporting for commercial companies, and there are some differences in generally accepted accounting principles between commercial and not-for-profit enterprises.

Board members could benefit from further instruction in reading financial statements, especially given that much of the information a prudent board requires is of a financial nature.

“Given that understanding financials is key to many board responsibilities, this is certainly an area where organizations could stand to improve,” says Kim McCormick, partner-in-charge of Grant Thornton's Greater Bay Area Not-for-Profit and Higher Education practices. “A best practice to consider is to provide basic training or a periodic refresher course for committee members to help with understanding financial statements. This enhanced understanding will help committee members recognize and respond to key issues in the financial statements such as liquidity, expense allocations and debt management.”

Board retreats

Ideally, boards should set aside time to step back and consider the big picture and the alignment of the organization's mission with its goals. Often this is achieved most effectively by arranging a board retreat away from day-to-day business demands. However, fewer than half (47%) of respondents said their organizations have an annual board retreat.

Oster says: “Organizations that do not currently have a board retreat may want to consider planning one. Such gatherings are a great opportunity to take a day or more to focus on preparing for key initiatives in the upcoming year, new industry developments (competitive, economic, regulatory and technology-related), and team building.”

Communication

Communication is at the core of effective governance. Because of this, it is essential to achieve the appropriate level of boardroom communication in which board members are well-informed and feel free to challenge one another and management. The good news is that nearly all (97%) survey respondents were comfortable challenging management on issues of concern. Board members also largely (91%) felt they were kept apprised of all legal matters affecting the entity.

Executive session

Executive session is a portion of a board or committee meeting during which all members of management, including management board members, are excused and nonmanagement board members have an opportunity to confer on issues privately. Executive sessions, which typically are not documented in board meeting minutes, may include discussions with the independent auditor regarding the organization's financials as well as issues involving management. Having regular executive sessions is widely considered a best practice for not-for-profit organizations of all sizes. Moreover, adding an executive session as part of the standard agenda of all board and committee meetings reinforces the notion that such sessions are routine and expected.

While 81% of respondents said their board has executive sessions without management, this leaves 19% that never convene in the absence of management. More than four in 10 (43%) boards met in executive session two to three times per year, while 28% met more than three times. Boards that fail to meet in executive session at all may be severely compromised in their ability to deliver on their governance responsibilities.

Having regular executive sessions is widely considered a best practice for not-for-profit organizations of all sizes.

Audit committees tended to meet in executive session with less frequency than the full board. Once a year (35%) was the most common timing for audit committee executive sessions, followed by two to three times a year (30%). Surprisingly, more than one-quarter (26%) of audit committees never meet in executive session. (For more information about audit committees, see "The audit committee" on page 10.)

Meetings with the auditor

Fewer than four in 10 (38%) respondents reported that their full boards meet with the independent auditor. This percentage has been decreasing steadily since 2005, when it stood at 53%. This trend more than likely reflects a growing tendency for audit committees to take the lead in working with the auditor. It is also consistent with the finding that an increasing percentage of audit committees are meeting with their auditors two to three times per year.

Despite the evidence that audit committees have become more active, the percentage of organizations for which the audit committee never meets with the auditor continues to hover around 7%.

Does your auditor meet with the full board of directors/trustees?



The role and structure of the board

Board focus

According to survey respondents, the most important focus of the board is either strategic planning (30%), fundraising (21%), ensuring effective programs (19%), or planning beyond the recession (8%).

Board size

Overall, board size in 2009 was largely consistent with our 2008 findings. Nearly four in 10 (39%) of the organizations surveyed have between 16 and 30 board members, followed closely by boards comprising six to 15 board members (37%). Fifteen percent have relatively large boards, comprising 31 to 50 members. A small number (6%) have more than 50 members.

Three-quarters of respondent organizations kept their boards the same size as in 2008. Fourteen percent added members and expertise to their boards, while 11% shrank their boards.

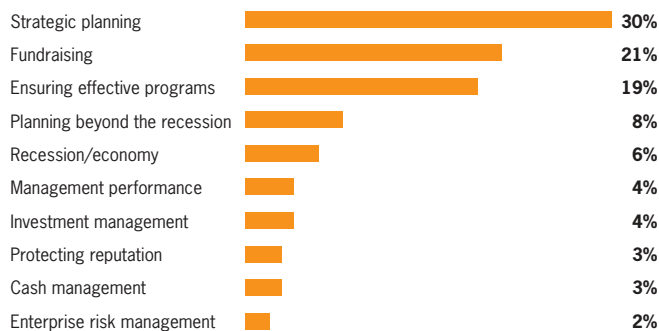
Committees

The type of committees most boards had in place remained very similar to our 2008 findings. These were executive (88%), finance (83%), audit (65%), nominating (58%), development/fundraising committee (55%), investment (42%), program (39%), compensation (35%), strategic planning (32%), governance (31%) and human resources (20%).

Term limits

Nearly eight in 10 (78%) respondents said their board members or trustees have term limits, up from 74% in 2008. More than two in 10 (22%) organizations reported not having term limits.

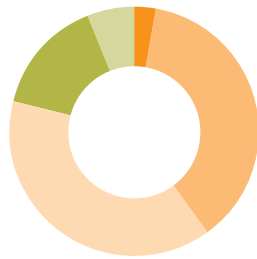
What is the most important focus of your board today?



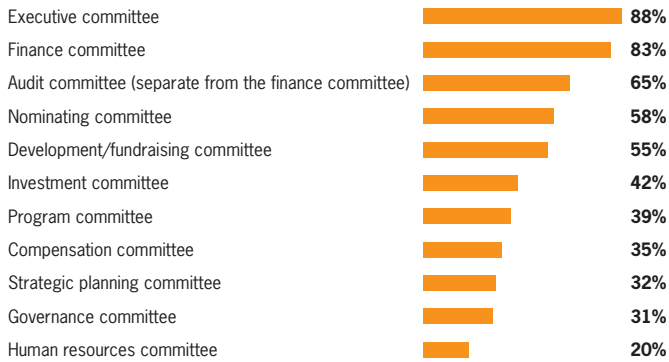
According to survey respondents, the most important focus of the board is either strategic planning (30%), fundraising (21%), ensuring effective programs (19%), or planning beyond the recession (8%).

How many directors/trustees serve on your board?

- 1-5 3%
- 6-15 37%
- 16-30 39%
- 31-50 15%
- >50 6%

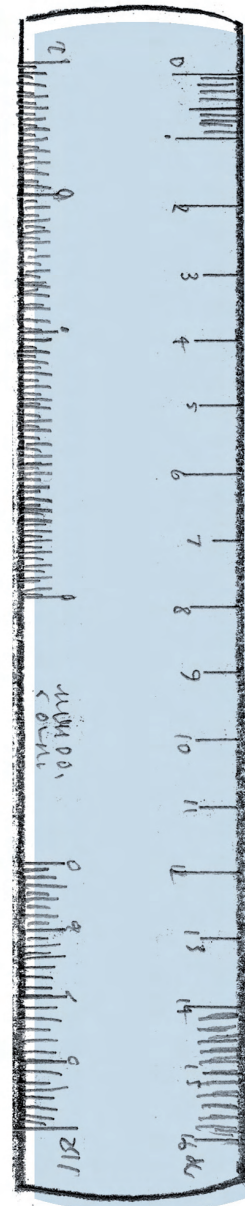


Which of the following board committees does your organization have?*



*Respondents were able to select more than one answer.

Nearly eight in 10 (78%) respondents said their board members or trustees have term limits, up from 74% in 2008.



The audit committee

The audit committee has three main missions: overseeing the establishment and implementation of appropriate accounting policies and internal controls so that financial reporting is accurate and reliable and fraud risk is mitigated; assessing the business risks for the organization and determining whether the not-for-profit organization is planning adequately for those risks; and monitoring the roles of the board, management, and internal and external auditors to ensure that the organization follows good financial governance practices.

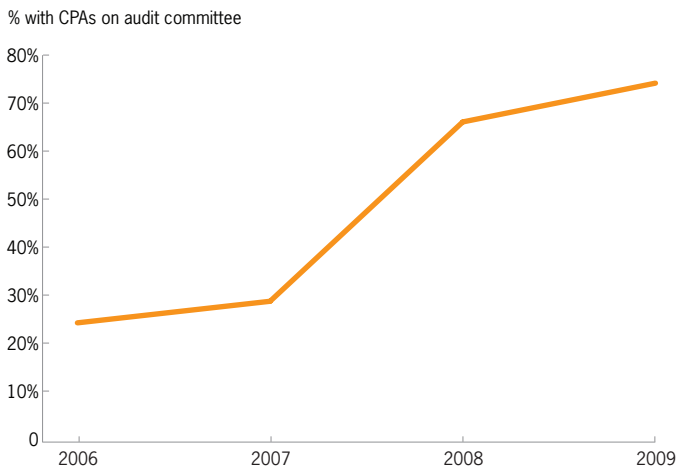
Composition

To fulfill its mission, the audit committee should include professionals who understand the fundamental principles of auditing, accounting, financial reporting and internal controls. There has been a clear increase in the percentage of audit committees that include CPAs. Nearly three-quarters (74%) of responding organizations' audit committees include a CPA, up from two-thirds (66%) in 2008 and only about one-fourth (24%) in 2006. Given the complexities of internal controls and governance, we expect this percentage to continue to rise. Organizations that do not have at least one CPA on their audit committee should strongly consider adding at least one professional who brings this credential and skill set.

Meetings with the auditor

More than half (52%) of audit committees met with the auditor either two or three times in 2009, up from 44% in 2008 and 35% in 2004. Conversely, the percentage of organizations for which a single meeting between the audit committee and the independent auditor is deemed sufficient is shrinking: In 2009, only 35% of audit committees met with the independent auditor only once, compared with 40% in 2008 and 54% in 2004.

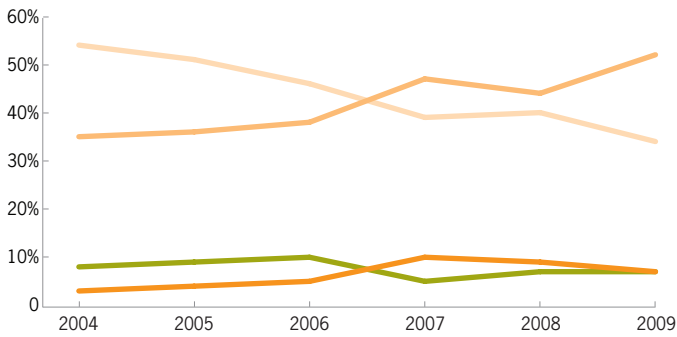
Does your audit committee include one or more CPAs?



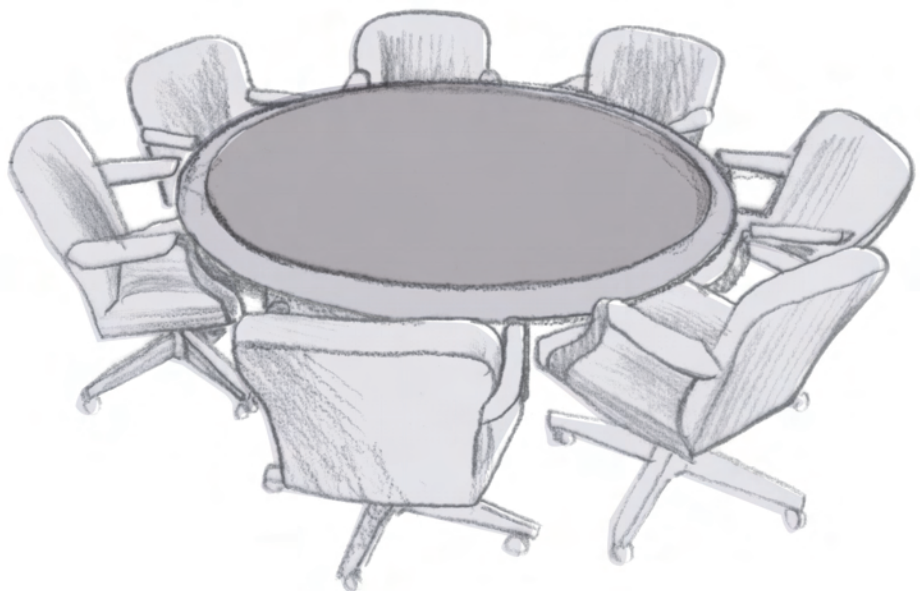
As a best practice, audit committees should meet with the organization's auditors at least twice a year: once to discuss the auditor's work plan and once to review the audit findings before they are presented to the board. However, the audit committee should feel free to meet with the auditors as often as necessary. In fact, it is not unusual for the auditor to meet with the audit committee four times or more per year, particularly among larger organizations.

How often does your audit committee or appropriate board committee meet with your auditor?

- More than three times a year
- Two to three times a year
- Once a year
- Never



As a best practice, audit committees should meet with the organization's auditors at least twice a year: once to discuss the auditor's work plan and once to review the audit findings before they are presented to the board.



Governance

There has been an enormous uptick in governance activities among not-for-profit boards since 2008, due to increased scrutiny of not-for-profit organizations, instances of fraud, changes to the Form 990, and an intensified push for not-for-profit transparency. The heightened attention has resulted in a flurry of activity and policy changes surrounding the Form 990, as well as several policy areas including whistleblowing, conflict of interest, record retention, investment and executive compensation.

As part of these efforts to increase accountability, boards have also become more focused on scrutinizing the performance of the board, CEO, CFO and development director. Three in 10 (30%) reported that one of the main ways the organization’s agenda changed in 2009 was that they spent more time evaluating CFO performance. Nearly one-quarter (24%) were paying more attention to evaluating board performance, while 14% became more focused on evaluating the performance of the executive director/CEO or development director.

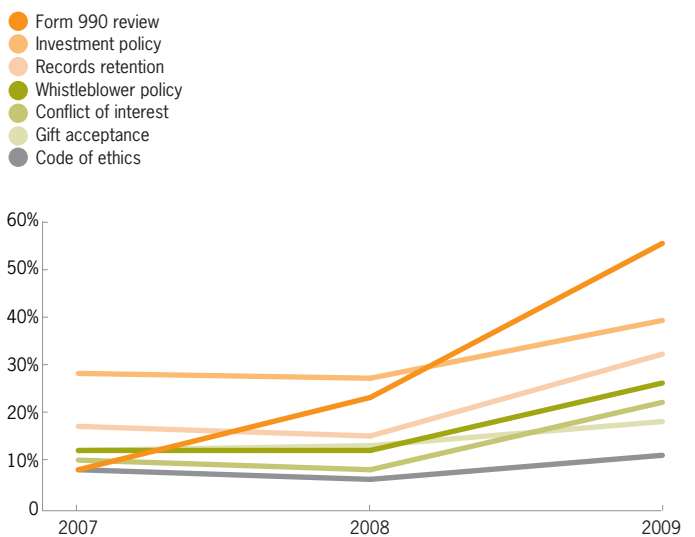
“It seems pretty clear that when finances are tight, organizations look to their leadership more than ever,” says Jakosz.

Form 990

Among the many policy changes boards undertook in 2009, Form 990 review was by far the leading focus for change, largely because not-for-profits had to file their first “new” Form 990. Consequently, more than half (55%) established formal policies for their board members to review the form, up from about one-fifth (22%) in 2008.

The new Form 990 was designed to enhance the transparency of organizations’ missions, governance practices, financial information, operations and use of resources. The new form requires each filing organization to provide certain information regarding the composition of its governing body, certain of its governance policies and practices, executive compensation, and the means by which it makes governance and financial information publicly available.

Which board governance policy changes have you made?*



*Respondents were able to select more than one answer.

To ensure the board is actively engaged in and fully aware of the information disclosed on Form 990, organizations are required as part of the new form to describe the process the board engages in to review the form. Because of this required disclosure, organizations are investing significantly more time preparing, reviewing and filing complete and accurate 990s. Nearly eight in 10 (78%) respondents indicated that their board and/or authorized committee, typically the audit or finance committee, reviewed the requirements of Form 990 and Form 990-T. However, 22% said their boards and committees did not.

Investment policies

Not surprisingly, nearly four in 10 (39%) respondents made changes to their investment policies in 2009, up from 27% in 2008. This makes sense given that many endowments experienced significant losses in 2008 and early 2009. The most effective investment policies are designed to create a disciplined — rather than reactive — approach that balances tolerance for risk, investment goals and asset allocation.

Audit committees have become more focused on investment policies, particularly those relating to alternative investments. In more than half (56%) of organizations surveyed, the audit committee has oversight over internal controls relating to investment policies and procedures, particularly alternative investments. This percentage increased from 42% in 2008.

Whistleblower policies

The percentage of boards updating whistleblower policies has more than doubled since 2008. More than one-quarter (26%) of respondents updated whistleblower policies in 2009, up from 12% in 2008. Overall, more than eight in 10 (84%) of respondent organizations have a whistleblower policy, an increase from 71% in 2008. Nevertheless, it is surprising that 16% still remain without such policies.

A formal whistleblower policy describes a process for staff, executives and other stakeholders to raise issues about the organization's ethical or financial practices without retribution. Such a policy also affords management the opportunity to learn of unethical or unlawful practices from employees rather than from the media, law enforcement or a regulatory agency. These policies are often linked to code-of-conduct statements to focus reported complaints on ethical issues versus employee dissatisfaction. Whistleblower policies are important in reducing overall organizational risk, and organizations that do not have such policies in place need to question whether they can afford not to.

Among those organizations that have a whistleblower policy, complaints most often go to the audit committee chair or a designated board member (33%), human resources director (15%), an outside company or law firm hired to monitor complaints (13%), or the organization's in-house legal counsel (9%). As a best practice, whistleblower complaints should not just be routed internally to members of management. They should go to the chair of the audit committee or board of trustees, or both.

Conflict-of-interest policies

More than one-fifth (22%) of respondents made changes to their organization's conflict-of-interest policies in 2009, up from 8% in 2008 and 10% in 2007. On Form 990, there are expanded disclosures required related to conflicts of interest, which are spurring much of this activity. An organization-wide conflict-of-interest policy ensures the independence of the board, management and staff, so that each of these parties performs only its designated role, and these roles are not compromised in any way. As a best practice, conflict-of-interest statements should be signed by senior management and board members, and employees who have responsibility for entering into financial transactions or have purchasing authority. There should also be ongoing monitoring of conflicts that arise throughout the year.

Among those organizations that have conflict-of-interest statements, nearly nine in 10 (87%) respondents required these to be signed by board and committee members, while nearly seven in 10 (66%) required executive management to sign these statements. Conflict-of-interest policies are sometimes also signed by other members of management (38%), all personnel (34%) and volunteers (7%).

More than one-fifth (22%) of respondents made changes to their organization's conflict-of-interest policies in 2009, up from 8% in 2008 and 10% in 2007.

Record-retention policies

Nearly one-third (32%) of respondents made changes to their record-retention policies in 2009, up from 15% in 2008. The Form 990 requires disclosing whether the organization has in place a record-retention policy. Moreover, some states' nonprofit corporation statutes establish a specific number of years that corporate and financial records should be retained. As a best practice, documents — including articles of incorporation and amendments, board meeting minutes, corporate resolutions, and annual financial reports — should be kept as permanent records.

Red flags programs

Interestingly, there was still relatively scant attention being paid to the Red Flags Rule among survey respondents. More than six in 10 (64%) respondents didn't know whether their organization even had a red flags program. Only two in 10 (20%) said their organization had a red flags program in place, while 16% said their organization did not.

The Red Flags Rule is a component of the Fair and Accurate Credit Transactions Act that encourages organizations that extend credit to develop a set of rules to mandate the detection, prevention and mitigation of identity theft. It is designed to combat identity theft by making it harder for criminals to use stolen identities. The rule lists 26 possible red flags that organizations may want to consider, but they are not required to use all — or even any — of these possible indicators. The FTC believes that Red Flags Rule compliance is important enough to be dealt with at the board level; the rule indicates that the board must approve the initial plan and review it on at least an annual basis.

We expect to see growing attention paid to the Red Flags Rule in the coming year as we approach the June 1, 2010, deadline for compliance.

We expect to see growing attention paid to the Red Flags Rule in the coming year as we approach the June 1, 2010, deadline for compliance. After this date, any occurrence of identity theft at a creditor organization exposes that organization to an FTC investigation, which can result in penalties, additional compliance reporting, fines and possible litigation.

Code-of-ethics policies

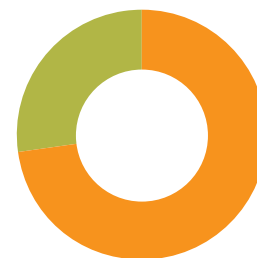
More than one in 10 (11%) respondent organizations made changes to their code-of-ethics policies in 2009, up from 6% in 2008. The code of ethics should address issues such as transparency, disclosure in fundraising solicitations, governance, integrity, and diversity.

Executive compensation

Form 990 disclosure requirements cast a spotlight on executive compensation among not-for-profits by creating an easily accessible format for anyone to view this information. The threat of IRS intermediate sanctions has also increased the board's focus on review of executive compensation. Nearly three-quarters (73%) of respondents said their organizations have formal policies in place to review executive compensation, up only slightly from 71% in 2008.

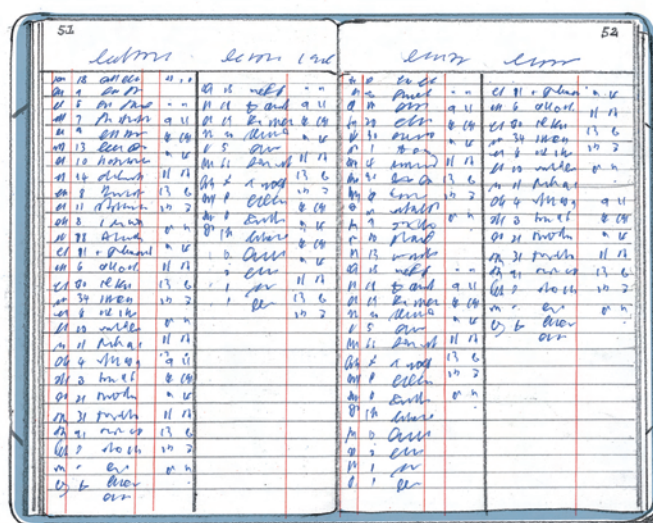
Do you have a formal policy for reviewing executive compensation?

- Yes 73%
- No 27%



Daniel Romano, partner-in-charge of Grant Thornton's national Not-for-Profit Tax practice, says: "Establishing a formal executive compensation review policy is a best practice for not-for-profit organizations. These policies serve to establish the reasonableness of compensation and also document the process behind it. This is particularly important when justifying compensation to the IRS, funders and the general public."

Rick Wentzel, partner-in-charge of Grant Thornton's West Not-for-Profit and Higher Education practices, notes: "Given the focus of Form 990 on executive compensation, it is somewhat surprising that 27% of organizations surveyed still do not have a formal policy to review executive compensation. This is required by law in certain states such as California."



Executive compensation in the spotlight

One of the major focus areas of the IRS, and of the federal government in general, is on the reasonableness of executive compensation. Indeed, it is also an IRS Exempt Organizations Division examination initiative. This focus is based on the fact that 501(c)(3) organizations are "owned" by the public and provided the benefit of tax exemption for benefitting the public. In order to be granted tax exemption, there are various organizational and operational tests an entity must satisfy. Among those tests is the prohibition on providing private benefits to "insiders," loosely defined as key individuals within the entity. An organization can pay reasonable compensation for services provided by the insider; in compliance with the prohibition, the compensation is statutorily held to a subjective measure of reasonableness.

When issues arise, IRS intermediate sanctions rules allow the IRS to allege that compensation is unreasonable and assess penalties on the key person, as well as reimbursements to the organization. There are also potential penalties on the individuals — board or management — involved in granting the compensation.

Since the term "reasonable" is subjective, the intermediate sanctions rules were written with a built-in safe harbor provision. This safe harbor — known as the rebuttable presumption of reasonableness — allows organizations to shift to the IRS the burden of proving unreasonableness. In order to shift this burden, an organization must contemporaneously document the process it went through for granting the compensation package, including comparison to similar entities, review by the board or committee, and independence of the process. The net effort of prohibitions, restrictions and potential shifting of the burden of proof in determining reasonableness is why establishing a formal executive compensation review policy is a best practice for not-for-profit organizations. This kind of policy serves to establish reasonableness and also documents the process behind the establishment, which provides an essential component in justifying the compensation package to the government, funders and the public.

About the survey

About the survey

Grant Thornton conducted its seventh annual *National Board Governance Survey for Not-for-Profit Organizations* between Oct. 14, 2009, and Nov. 6, 2009. Responses to the web-based survey were received from 465 CEOs, CFOs, board members and other top officials of higher education institutions, trade and professional associations, social and human service organizations, religious organizations, cultural organizations, health care organizations and foundations.

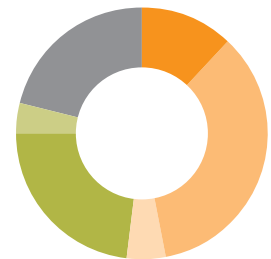
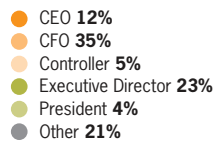
More than one-quarter (26%) of respondents are board members, while nearly three-quarters (74%) hold other positions within their organization, such as CEO, president, chief operating officer, CFO, controller or vice president. Of management respondents, CFO was the most frequently held position (35%), followed by executive director (23%), CEO (12%) and controller (5%). Among board respondents, 45% are members of the audit committee.

The majority (71%) of respondents' annual revenues were less than \$50 million. Ten percent had annual revenues of between \$50 million and \$100 million. Twelve percent of respondent organizations' annual revenues were between \$101 million and \$500 million. Seven percent had revenues in excess of \$500 million.

The *Grant Thornton National Board Governance Survey for Not-for-Profit Organizations* is published by Grant Thornton LLP. It is not intended to answer specific questions or suggest suitability of action in a particular case.

We would like to thank all the respondents for taking the time to complete our seventh annual *National Board Governance Survey for Not-for-Profit Organizations*. The survey would not be possible without your participation.

What position in management do you hold?



About Grant Thornton LLP

About Grant Thornton LLP

The people in the independent firms of Grant Thornton International Ltd provide personalized attention and the highest quality service to public and private clients in more than 100 countries. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the six global audit, tax and advisory organizations. Grant Thornton International Ltd and its member firms are not a worldwide partnership, as each member firm is a separate and distinct legal entity. In the U.S., visit Grant Thornton LLP at www.GrantThornton.com.

About Grant Thornton's Not-for-Profit practice

Grant Thornton's Not-for-Profit practice is dedicated to serving a broad range of not-for-profit organizations nationwide, including colleges and universities, trade and professional associations, religious organizations, social and human service organizations, museums, cultural organizations and foundations. Grant Thornton offers a complete array of services designed specifically to help our not-for-profit clients meet their audit, tax and business needs.

We also provide business advisory services for mergers and acquisitions, compensation and benefits planning for executives, risk management, internal audit consulting, forensic investigations, and governance consulting for boards of directors and trustees.

We believe that our Not-for-Profit practice is now the second largest not-for-profit practice in the country and is on track to become the number-one such practice among accounting firms in the near future. On behalf of all the partners and employees of our firm, we wish to thank our clients for making this possible.

About the Board Governance Institute

Grant Thornton's Board Governance Institute serves to keep board members and senior management of not-for-profit organizations abreast of current and emerging accounting, regulatory, legal and operational issues. The Board Governance Institute provides members with the information necessary to effectively oversee their organizations' operations. Members receive timely industry alerts, information about current trends, and up-to-date resource tools on issues affecting the not-for-profit industry. In addition, Board Governance Institute members receive invitations to exclusive seminars, roundtable discussions and classes. Membership in Grant Thornton's Board Governance Institute is offered pro bono as part of our firm's ongoing commitment to the not-for-profit community. To sign up for the Board Governance Institute, visit www.GrantThornton.com/bgi.

For more information about the survey or Grant Thornton's Not-for-Profit practice, visit our website at www.GrantThornton.com/nfp.

