

Ethical Responsibilities of Boards of Directors of Non-Profit Organizations

A Briefing

The ethical responsibilities of non-profit directors are generally defined by the specific duties delegated to them by law and custom. Those are the *duty of care*, *duty of loyalty*, and *duty of obedience*. From within each of these duties we can define the types of specific considerations and actions a non-profit board member should take to fulfill their ethical responsibilities as directors.

This briefing is prepared from a practical, rather than a legal, point of view and it is not practical or useful to address every ethical situation a director may face. Therefore, the information offered here is an overview and is intended to help directors be as effective as possible in their non-profit service. Legal protections and responsibilities, which vary from state to state, may not always serve to raise the level of directors' effectiveness. That is, a director may fulfill the requirements of her or his respective state laws regarding their duties as directors, but will not necessarily be effective directors. Legal questions related to specific situations are best answered by attorneys.

Duty of Care

The duty of care means that directors have a responsibility to act in ways that an ordinarily prudent person would act if he or she were in a similar position and under similar circumstances. In essence, the duty of care means that a director will exercise reasonable care when making decisions regarding the organization.

This may be the most challenging duty for a director to fulfill. While the definition seems straightforward enough, the term "care" is subject to interpretation and, thus, may prove troubling for some individuals who want to ensure they are serving fully and competently as directors. For example, it can be argued that the duty of care implies that a board member has a full understanding of the organization, its processes, and its operations—including the background information needed to gain such an understanding.

The list that follows, then, is extensive. It is not, however, comprehensive. Each board and each director must discern the means to fulfill their ethical responsibilities. Although each director should be equal on a board, not every director is charged with the same expectations for serving the organization. Some directors are recruited specifically for their financial or legal background, for example. Thus, their emphases in serving as directors are likely to be on their respective areas of expertise. Yet other directors are selected because of their wealth of contacts and potential for raising funds for the organization. They may lack financial or legal expertise, just as the legal and finance specialists may lack the kinds of community or other contacts the organization seeks.

Nevertheless, every director is accountable for understanding the organization, its structure, and its operations. Directors, no matter what their reason for being elected to a board, are responsible for making decisions and setting policy for the organization. Therefore, the ethical (and legal) responsibilities of all directors include fulfilling their duty of care in a variety of ways.

Fulfilling the duty of care includes:

- Reading and thoroughly understanding organizational governance documents, such as the charter, bylaws, and operating procedures.
- Reading, reviewing, and thoroughly understanding meeting minutes. Additionally, directors must ensure that minutes accurately reflect their impressions of the proceedings and decisions of meetings they attended.
- Reviewing and thoroughly understanding financial reports and budgets. Directors must inquire about any discrepancies or variances and persist in their questioning until adequate answers are

provided. This assumes that directors have an understanding of how to read financial reports, for non-profits especially income statements. Thus, fulfilling the duty of care includes, if necessary, learning to understand such reports and the basis upon which they are prepared.

- Reading and understanding the results of any financial audits. Each director must ensure that auditors' recommendations are fully considered and implemented if found to be relevant and appropriate. Moreover, each director should insist on periodic updates from the chief staff executive regarding the status of the implementation of such recommendations.
- Giving due attention to all organizational matters that come before the board or to the attention of its directors through a lens of *both* experience and the specific needs and interests of the organization. Experience, either with other non-profit organizations or in other realms of the world, is useful and may be a prime qualification for directors in many organizations. On the other hand, experience does not necessarily translate directly to specific situations a non-profit organization faces. A director who is exercising due care in fulfilling board responsibilities will make an effort to recognize when outside experiences might inform a decision or action and when new thinking is needed, not being bound by conceptions that something that worked elsewhere on another occasion is necessarily appropriate, feasible, or ethical in every somewhat similar circumstance.
- Thinking critically about all matters coming before the board or under its purview, but always with a positive intention to ensure decisions are correct and serve to advance the organization and its mission. Critical thinking is not negative and must not be an avenue to undermine any individual, a majority-approved decision, or the overall advancement of the organization.. Rather, it is the process of weighing a proposition (or fact) that is presented against common knowledge, common sense, and other relevant evidence to ensure that the idea is valid and workable.
- Ensure the organization has adequate resources to fulfill its mission. To this end, every board must be proactive in helping to procure resources to accomplish the organization's mission. Members need to work with the staff through the chief staff executive (and chief development officer, as appropriate) as partners in the development process, from planning through fundraising activities. This entails being involved in fundraising and making personal contributions.
- The board must also give due attention to structural components that affect financial stability, including ensuring the organization's human resource development, directing long-term financial planning, balancing entrepreneurship with fiscal responsibility, setting each unit's budget, being involved in administrative improvements, and reviewing key financial controls.
- The board must be responsible for selecting the organization's chief staff executive. No decision affects an organization more than this selection. The board of directors must develop a consensus job description for the position, carry out a thorough search for the best possible candidate, and make a careful selection that will best serve the organization.
- The board must work in partnership with the chief staff executive to ensure optimal performance for the organization. This will sometimes mean disagreeing with or questioning the CEO's plans or actions. More frequently, this will mean providing support. Whatever the action, directors should always consider themselves colleagues with the CEO.
- The board should provide an annual performance evaluation for the chief staff executive based on objective criteria as defined by the position's job description and relative to the organization's mission, vision, values, and adopted plans.
- Based on the results of regular evaluations or emergency situations, the board must be willing to discharge a chief staff executive whose conduct is detrimental to the organization to such a degree, based on objective criteria, that achievement of its mission is compromised or it may be liable for legal or regulatory action.

Duty of Loyalty

The duty of loyalty means that a director must be loyal exclusively to the organization being served, must never act for personal gain, and must always consider the best interests of the organization when making decisions that affect it. The duty of loyalty is primarily external, in that tests of the director's loyalty most frequently come from outside the organization (as compared with the duty of obedience, which is generally internal because situations that test the director's obedience usually originate inside the organization or from other people directly involved with it).

Fulfilling the duty of loyalty includes:

- Not serving in leadership roles in organizations that are in opposition or competition. It might be argued that a board member one organization should not be a member of, or even otherwise support, another opposing or competitive organization.

This issue is problematic on multiple fronts. First, while one organization's mission may be seen as antithetical to that of another organization (for example, the National Rifle Association versus The Brady Center to Prevent Gun Violence), a board member may believe there are good reasons to support both entities, such as particular worthy programs or activities they undertake.

Second, non-profit, especially charitable, organizations should not actually be in competition with one another in the sense that competing businesses operate in the same markets. Nevertheless, there are situations where multiple non-profits exist to serve the same or very similar purposes. This is notable on the local level, where any given community has multiple non-profit organizations. Generally, each organization has its own specialization that does not on its face encroach on the territory—regional or service-wise—of another. Even so, organizations with seemingly disparate missions will frequently find themselves in competition for funding, either private or governmental. This is because the categories of funding offered may be broad enough to encompass the missions and programs of both organizations. (An example might be of an after-school enrichment program for K-5 students that is in competition with a pre-school for grant funding from a private foundation that supports Pre-K-5 services.) Therefore, if an individual served on the boards of both organizations, a question of loyalty might arise, especially if the board member was, for example, called upon to use influence or contacts to support the grant application. At the very least, the organization not getting this assistance might feel the board member was being disloyal and quite possibly the director would be in a significantly conflicted position if both organizations asked for such help.

There are situations, however, in which organizations may be competitive in some ways, but on the whole each organization's mission is complementary to one another. For example, an individual may serve on the board of a national professional organization. There may also be a local organization that serves the same profession, but which is independent of the national organization, specifically not one of its chapters. While it may be considered a conflict (disloyal) by some for an individual to serve as a director of both organizations, in fact while they probably serve overlapping purposes and constituencies, each is likely to be different enough in the services they offer that there is little likelihood for the director to be in a conflict.

Third, board members are privy to confidential information. They have an obligation to keep this information private. Failure to share critical information with another organization to which the director belongs or serves as a leader may be seen as disloyal, even though the director is living up to the duty of loyalty (and in some cases his or her legal obligation) to the first organization by withholding it. Clearly, sharing validly private information is a disloyal act and the loyalty shown to the receiving organization is misplaced.

- Living up to commitments to support the organization. At the most basic level, this means attending meetings and other events of the organization. More specifically, this means choosing to attend the organization's meetings even when the director has a scheduling conflict. Virtually every organization has had board member absentees because of a meeting conflict. In sum, the

director chose some other activity over that of the organization. Sometimes these conflicts are unavoidable and the director must make a prudent and rational decision for one activity over the other. For example, an urgent work-related or work-mandated responsibility must take precedence over a board meeting or organization event. If, however, the conflicting event no significant potential consequences, such as watching a sports playoff game on television, the decision to not attend the meeting or event would be disloyal.

Duty of Obedience

The duty of obedience requires board members to be faithful to the organization's mission. Their actions must never conflict with the goals and objectives of the organization.

Fulfilling the duty of obedience includes:

- Abiding by the established rules and norms of the organization. Every director should be familiar with the organization's bylaws and ensure that they are followed, both individually and collectively. Similarly, board members should understand and abide by the norms established by the organization. For example, most organizations have developed a norm (and some a written policy) that board members should not have independent contact with staff members to discuss issues related to the organization. There should, of course, be established means for a director who becomes aware of any organization-related issue to call for the matter to be addressed or investigated. Directors should be free to use such channels, but should not pursue their own investigations.

The duty of obedience (or loyalty) does not, however, exempt a director from reporting illegal activities to outside authorities *if the internal process has inadequately addressed perceived problems*. For example, a board member may discover that organizational funds are being misused to such a degree that laws are clearly being violated. Further, the director may discover that the board chair is aware of the misuse of funds, but has done nothing to stop it. The director, nevertheless, is bound to raise the issue within the board and only take it to outside authorities if appropriate investigation and remediation is not taken internally.

- Supporting any consensus or majority decisions of the governing body. Although a director should vigorously defend her or his position on any given issue and ensure that he or she is fulfilling the duty of care in participating in the process that leads to a decision, once the decision is made, every director must stand behind it. Otherwise, the board and by extension the organization becomes fractured, which will lead to further conflicts.
- Work to change organizational governance policies, procedures, and documents only through established channels. Every organization should have established means for amending its governance documents and for directors to introduce initiatives to the board. These procedures should be followed. That is not to say that directors are forbidden by obedience to discuss their ideas or concerns with other directors outside of meetings. Nevertheless, a non-profit board is not a legislature in which it should be necessary to line up votes or sponsors in advance of a proposition being submitted to the board. Widespread lobbying outside of board meetings tends to create division among the board, destroying its collegiality.
- Ensure that funds received by the organization are used as intended by the donor. Funds should not be accepted for a specified purpose and later used for other purposes, either for need or convenience.

Ethics is not merely complying with laws, although that is one component of ethical action. Laws are intended to regulate from outside; ethics is intended to regulate from within. Every non-profit director, however, is bound to comply with both.

The S.F. Gray Company is widely experienced in helping organizations develop their governance structures to ensure the highest levels of ethical responsibility. Please call us for a consultation.