



The Leadership Role of ECFA Members

...Boards must lead the way

ECFA members are leaders in the Christian community and in the broader non-profit arena. Based on more than 25 years of solid history, the value of the ECFA seal associated with member-ministries is increasingly recognized by the donor public.

The reputation and credibility established by ECFA members is wonderful but this is not a time to rest on our laurels. Whether or not Congress passes additional legislation directed at the non-profit world, it is clearly a time for boards of ECFA members to step up to the challenge of providing even greater leadership in our sphere of influence.

One thing is clear—the ministry governance climate has been significantly altered, particularly in the way boards conduct their deliberations, perform due diligence and evaluate and recruit board members. There is more focus by the government, regulators, and donors on nonprofits than in perhaps 25 years.

Here are five areas where the governance landscape has changed:

- **Board self-assessment.** Boards are increasingly seeing the value of board self-assessments. In a recent survey, directors were asked which of the recent corporate governance reforms was likely to have the most significant impact on the

effectiveness of boards in general. Board assessment ranked fourth out of a list of 12.

Nominating and governance committees are typically responsible for the board assessment process (otherwise, the executive committee often takes the responsibility). The committee must ensure the board assessment fulfills its potential—and doesn't simply result in a ho-hum paper-pushing exercise.

Improving board performance is a challenge for many ministries. Board self-assessment is increasingly considered an important

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tool to energize board members and make them eager to focus on their leadership roles.

Self-assessments develop the board's team-building skills and provide a better problem-solving structure. It is a clear signal that board members take their responsibilities seriously.

A self-assessment gives the board an opportunity to step back from its everyday business and address larger, more fundamental issues. In addition to allowing boards to reflect on how well they are meeting their responsibilities, a self-assessment helps boards focus on integral aspects

of their work—from strategic direction setting and oversight to fund-raising and ministry outreach. (A full article on this topic will appear in the next issue of *FOCUS on Accountability*.)

- **Audit committee.** ECFA has focused on the importance of the audit committee for years. The face-to-face meeting with the auditor is a key communication opportunity for the audit committee. (See California legislation, page 7, that would require an audit committee for nonprofits with gross revenue of \$2 million or more.)

ECFA's Standard No. 2 requires either “the board or a committee consisting of a majority of independent members shall review the annual audit and maintain direct communications between the board and the independent certified public accountants.” While ECFA Standards permit these responsibilities to be carried out by the board or a committee, an audit committee should be used by all except the very smallest ministries to ensure adequate time and attention is given to audit-related matters.

Under Standard No. 2, the board or a committee of the board, must meet with the auditor at least once a year. If the geographical location of the participants is an issue, this meeting may occur via a telephone conference call—but the meeting must occur.

The Sarbanes-Oxley requirement of having at least one individual on the audit committee with financial expertise doesn't apply to nonprofits but it is certainly a concept worthy of consideration. Financial expertise is

one qualification to be considered when recruiting board members. Ministries without a board member who is conversant with nonprofit financial issues could invite one (or more) non-board members possessing financial expertise and familiarity with your ministry to join the committee (unless state law restricts committee members to those who are board members).

• **Related-party transactions.** There is increasing concern about related-party transactions. Even when related-party transactions are truly in the best interest of the ministry and properly documented, a significant transaction may raise concerns with donors and the public.

Proper handling of related-party transactions starts with an adequate policy covering both board members and key executives. (ECFA has sample policies

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at www.ecfamembers.org in the Topics of Interest section, see Conflicts of Interest.)

Of nearly equal importance is an annual questionnaire used to document any potential related-party transactions. The completed questionnaires should be reviewed by the board governance or executive committee, for example, with a summary provided to the board chair.

Significant related-party transactions should be approved by the board and documented in board minutes. All significant ongoing related-party transactions

should be annually reviewed again by the board to determine if they continue to be in the best interest of the ministry. The recusal from discussion and vote (even to the point of leaving the board room while the matter is under discussion) by the related party is vital to demonstrate independent board decisions.

• **Documenting executive compensation.** Whether a ministry compensates its top executive at a modest or more aggressive level, contemporaneous

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documentation of the compensation package (gross pay and all fringe benefits) is a must.

Without proper documentation, IRS agents are instructed (2004 IRS Continuing Professional Education text, <http://www.irs.gov/charities/index.html>) to automatically treat undocumented compensation as an “excess benefit,” even if the payments would have been considered reasonable compensation if properly documented.

Example: A ministry wants to reward its CEO for 30 years of faithful service. Although the board approved \$10,000 for an overseas vacation for the CEO and his wife, the ministry did not include the \$10,000 on the CEO’s W-2 or withhold appropriate payroll taxes. Even though the additional \$10,000 of compensation, when combined with the CEO’s regular salary, was reasonable, the failure to include the \$10,000 in the payroll reporting process gives the IRS a basis

to treat the amount as an excess benefit transaction. The potential penalty assessed on the executive is 25% of the benefit plus another 200% penalty unless the benefit is returned within a limited period of time. ☉