

The 2007 Grant Thornton LLP

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

Grant Thornton 



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## About governance and accountability

In recent years, there has been an increased focus on the governance of not-for-profit organizations nationwide. For instance, Senate Finance Committee Chair Sen. Max Baucus and ranking minority member Sen. Charles Grassley jointly issued a press release this past spring reacting to the Internal Revenue Service's (IRS) 2007 list of the "dirty dozen tax scams." Making No. 10 on the IRS list was "Abuse of Charitable Organizations and Deductions."

Agencies, including the U.S. Government Accountability Office and the New York state attorney general, have conducted well-publicized investigations into links between university financial aid officers and student loan providers.

The IRS Exempt Organizations Division has increased its staff to 950, up by 100 in the past five years. The IRS has also issued substantial revisions to the Form 990 tax return focusing on such issues as executive compensation and conflicts of interest.

In addition, stakeholders in not-for-profit organizations expect much higher levels of accountability and transparency than in the past.

For further information on the implications of changing expectations for your organization, visit Grant Thornton's website at [www.GrantThornton.com/nfp](http://www.GrantThornton.com/nfp) or contact the Grant Thornton office nearest you.

# The fifth annual **National Board Governance Survey for Not-for-Profit Organizations** depicts how organizations have sharpened their governance knowledge and are implementing an array of governance-related policies and procedures.

Grant Thornton has published this survey for five consecutive years as part of our continued commitment to developing thought leadership for and about emerging issues in the not-for-profit community.

Since we began conducting the survey in 2003, the governance landscape of the not-for-profit community has changed dramatically. In 2003, 80 percent of survey respondents said their organization had not made any changes to their governance policies as a result of Sarbanes-Oxley. Today, 87 percent indicate their organizations have created new governance policies.

Regarding specific policies, 75 percent of today's respondents say their organization has a code-of-ethics policy, compared to 17 percent in 2003. And 89 percent have a conflict-of-interest policy, a substantial increase from 24 percent in our first survey.

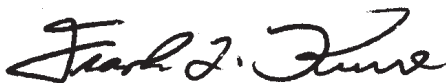
In 2003, whistle-blower policies were a newer concept to not-for-profit organizations, which was reflected in the finding that only 16 percent had such a policy in place. Today, 68 percent of respondents say their organization has implemented a whistle-blower policy.

These findings show a community that is determined to hold itself accountable for its actions — both fiscal and strategic — and is committed to serving not only its constituents but, ultimately, the “greater good.”

In honor of our fifth annual survey, this survey report not only includes an overview of our findings, but also articles providing best practices for each of the six areas the survey covers. For continued educational opportunities, I invite you to join Grant Thornton's Board Governance Institute Education Forum. The Education Forum features complimentary seminars and roundtable sessions on topics related to board governance issues, legislative and regulatory updates, tax updates and business, accounting and financial matters. To join, visit [www.GrantThornton.com/bgi](http://www.GrantThornton.com/bgi).

If you have any questions regarding this survey, or any other topic, please feel free to contact your local Grant Thornton partner or manager, or me directly at [Frank.Kurre@gt.com](mailto:Frank.Kurre@gt.com) or 212.542.9530.

Warmest regards,



Frank L. Kurre  
National managing partner of Grant Thornton's not-for-profit industry practice



# Policies

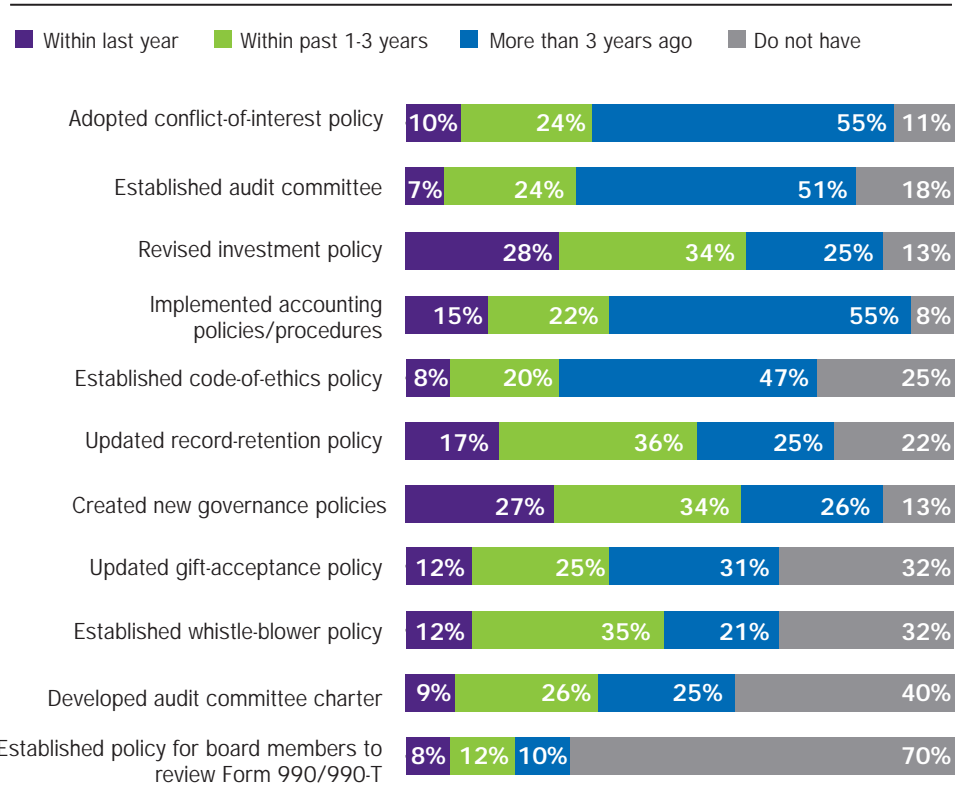
## Which board governance policy changes has your organization made?

Many not-for-profit organizations have enacted policies and procedures consistent with the Sarbanes-Oxley Act. Most notably, 92 percent of respondents have implemented new accounting policies and procedures, compared to only 59 percent in last year’s survey. This sizeable movement is likely the result of board members encouraging an expansion of internal control documentation and recent changes to the Form 990, the required and publicly disclosed IRS “tax return” that most not-for-profit organizations must complete. The Form 990 is accessible to anyone but is often of special interest to the press, significant donors, government funding sources and watchdog agencies.

Eighty-nine percent of organizations have adopted a conflict-of-interest policy. Of these, 55 percent say their policy is more than three years old. With the IRS Form 990 requiring the disclosure of various board and senior management relationships, and clarifications from the IRS on question 75 of the Form 990, conflict-of-interest statements need to be revised by many not-for-profit organizations to capture currently required information.

Because of the growing number of not-for-profit organizations investing in alternative investments, investment policies continue to be an important area of focus for organizations: 87 percent of respondents have adopted a written investment policy, compared to 63 percent in 2006. Investment policies should be revised periodically, especially if an organization is investing in new types of investment vehicles or significantly changing investment strategies.

## Governance policy changes



More than three-quarters (78 percent) of organizations have updated their record-retention policies. Record-retention policies should include procedures for retaining both hard-copy records and electronic files. Incorporating electronic files and e-mail retention into the policy is essential in today’s technology-driven marketplace.

More than two-thirds (68 percent) of respondents have a gift-acceptance policy in place, compared to 44 percent in 2006. These policies should include procedures for accepting or declining gifts from vendors and potential vendors.

As a best practice, organizations should decline gifts from a potential vendor during the bidding process and only accept gifts from a vendor if there is a business purpose and the gifts are nominal in value. In the case of non-cash donations, the policy should outline the procedures the organization performs prior to accepting gifts. For example, potential real estate gifts should be reviewed to ensure there are no environmental hazards prior to gift acceptance.

## Assessing reputational risk: Protecting your organization's good name

Most board members and executives would agree that a not-for-profit organization's most important asset is its good name and reputation. Lose that and an organization can lose its funding, donors, clients, students, employees and board members. In fact, loss of reputation may result in the very destruction of the not-for-profit organization itself.

Many organizations have been engaging in enterprise-wide risk assessments over the past several years to evaluate all risks, including environmental, regulatory, governance, financial and programmatic risk. Most recently, there has been a significant focus by many organizations in assessing reputational risk, which is considered to be a subset of an overall enterprise-wide risk assessment.

### What is reputational risk and how should it be assessed?

Reputational risk assessment is a comprehensive review of what an organization is doing to protect and enhance its reputation and what an organization may be doing, in fact or in appearance, that may damage its reputation. Reputational risk can be measured, for example, by how the media or a watchdog agency such as Charity Navigator or the Better Business Bureau may interpret and present certain practices.

Reputational risk assessment must be assessed on several levels including, but not limited to, the following:

**1) GOVERNANCE.** Effective governance requires that well-thought-out bylaws and board policies be put in place, including appropriate conflict-of-interest statements. Board members need to ensure that conflicts do not arise in fact or in appearance. Board members must

always act in the best interest of the not-for-profit organization and avoid self-benefit.

**2) EMPLOYEE PRACTICES.** Employee practices that result in a hostile work environment or cause poor employee morale can affect an organization's reputation. Implementing a whistle-blower policy and upward feedback about management can help mitigate risks in this area. Each not-for-profit organization's work environment should be a great place to work to further the mission of the organization and demonstrate proper social responsibility.

**3) EXTERNAL COMMUNICATIONS.** Clear, concise and truthful external communications are essential to protecting an organization's reputation. Messages that are vague, contradictory or inaccurate can seriously damage an organization. Carefully crafted communications and effective use of the media are important elements in protecting and enhancing an organization's image. "Think straight, talk straight" is the motto here.

Protecting and enhancing the reputation of a not-for-profit organization is critical in today's world. Performing a reputational risk assessment as part of a board or management retreat or as a key part of strategic planning will benefit an organization's long-term viability.

Reputational risk assessment also involves an ongoing monitoring process to ensure that an organization's reputation is protected and enhanced. Not-for-profit organizations cannot effectively achieve their missions if their reputations are not in good standing.

While still an emerging trend, only 30 percent of survey respondents have a policy in place requiring the board or one of its committees to review the organization's Form 990. Form 990 is the most public financial document available about a not-for-profit organization. Many more

interested parties will read a not-for-profit organization's Form 990 than will ever read its audited financial statements. To ensure an organization's information is presented completely and correctly, the audit or finance committee should review the Form 990 before it is filed.



**If your organization has a conflict-of-interest policy, who signs it?**

A conflict-of-interest policy applies to situations in which the interests of the board, management, staff and volunteers come into conflict, or appear to come into conflict, with the mission and goals of the organization.

More than nine out of 10 (94 percent) respondents require board members to sign a conflict-of-interest disclosure statement, compared to 89 percent in the 2006 survey. More than two-thirds (68 percent) have executive management sign — an increase from 50 percent in 2006. Requirements for committee members to sign such a policy are also on the rise: 41 percent this year, compared to 29 percent in 2006.

Who signs the conflict-of-interest policy?



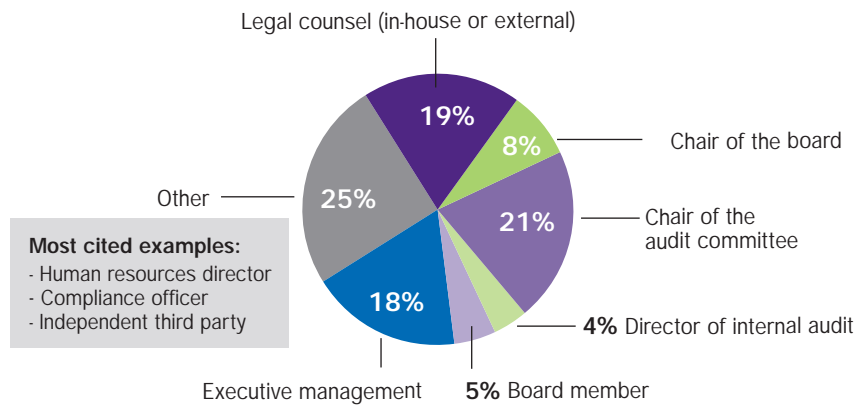
**Who are whistle-blower complaints submitted to in your organization?**

Whistle-blower policies provide a channel through which employees can anonymously report concerns regarding internal controls and financial reporting. Nearly seven out of 10 (68 percent) respondents have a whistle-blower policy in place.

With Form 990 soon requiring organizations to indicate whether they have a whistle-blower policy in place, this percentage should increase in the near future.

As a best practice, all organizations should establish a formal whistle-blower policy. The adoption of such a policy not only opens the line of communication, but also demonstrates accountability and proper stewardship.

Who are whistle-blower complaints submitted to?



## Board structure

### Do your board members/trustees have term limits?

Eight out of 10 (80 percent) of survey respondents say their board members or trustees have assigned term limits, a slight increase from 76 percent in 2006.

The majority (57 percent) of organizations set term limits between two and four years and one-quarter (26 percent) have term limits between five and seven years.

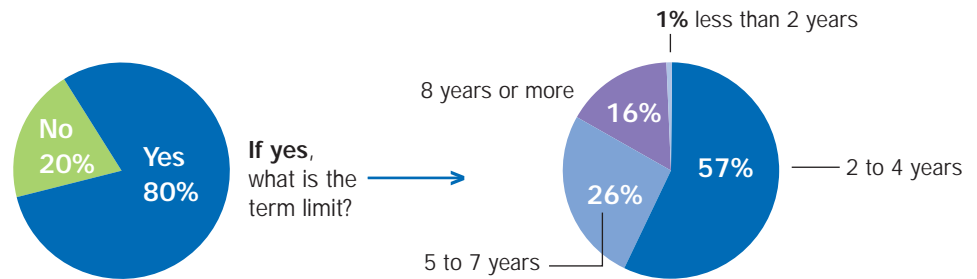
Term limits have many associated benefits, including an increase in new ideas and different perspectives, a lower risk of the board becoming too closely aligned with management and the opportunity to invite new board members who have experience in areas the current board may be lacking.

### Does your organization carry directors' and officers' (D&O) insurance?

Many not-for-profit organizations carry D&O liability insurance to protect their board members from legal liability.

Almost all (96 percent) responding organizations carry some level of D&O insurance. Organizations should have their D&O policies evaluated annually to assess the level and type of coverage needed based on an organization's business and the constituencies that are served.

### Do your board members/trustees have term limits?



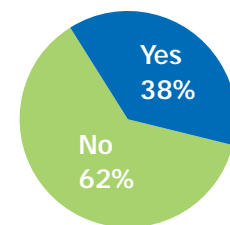
### Does your board perform an annual self-assessment of its performance?

Consistent with last year's findings, only 38 percent of survey respondents say they perform self-assessments.

Self-assessments can assist boards in determining how well they carry out their responsibilities and identify areas for improvement.

Areas reviewed may include the board's structure, its capacity for understanding business operations, board succession planning, leadership of the board and committee chairs, oversight over internal controls, the board's relationship with management and transparency in dealing with an organization's constituencies.

### Annual self-assessment



## Understanding board member liability

Not-for-profit board members face several types of potential liability. One is liability to third parties, such as a contractor who provides services to the organization, or to a significant donor or funding source. Another is liability to the organization itself and to its various constituencies.

A board member has a fiduciary obligation to the organization. He or she must act with good faith and loyalty and in the best interest of the organization. Board members are also subject to statutory liability, which varies from state to state.

A board member has a legal duty to conserve and protect an organization's assets. Many not-for-profit organizations carry D&O liability insurance to protect their board members from legal liability. Board members should be aware of whether or not an organization carries this insurance and how extensive the coverage is.

In addition, some states have adopted volunteer-protection statutes that may offer some protection for uncompensated board members and trustees.

Some companies have established a policy that their senior executives or employees are not to sit on boards of organizations that do not have adequate D&O liability insurance. Having the correct level of insurance can help your organization attract desired board members.

Claims against individual board members of a not-for-profit organization can arise from a number of situations, including:

- Employees claiming wrongful termination or other violation of their rights.
- Governmental entities claiming waste of assets or violation of laws and regulations.
- Environmental damage from toxic waste on property an organization owns or acquires.
- Service recipients claiming negligent supervision or improper selection of employees and volunteers.
- Violation of regulations on lobbying efforts.

Congress has also passed legislation that imposes financial penalties on board members for improper dealings with not-for-profit organizations or for knowingly approving excessive transactions with organization insiders.

Conflict of interest can also be the basis of liability action against a board member. If a board member receives an improper or undisclosed personal financial benefit as a result of the organization's transactions, he or she may be liable to the organization.

The idea of personal liability is another reason organizations should ensure they are providing their board members with the proper D&O insurance protection.



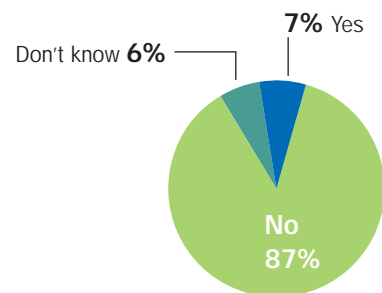
## Board oversight of investments

### Does your organization hold investments in funds in which a board member serves as an officer, director or general partner of the investment fund?

Seven percent of responding organizations hold investments in funds in which a board member serves as an officer, director or general partner of the fund.

In general, such practices should be discouraged to avoid the appearance of a conflict of interest. At a minimum, as in all conflict-of-interest situations, the relationships should be fully disclosed to the board and in the Form 990 and footnotes to the audited financial statements. In addition, the board member involved should not participate in discussions or any vote relating to these investments.

Board member involvement with investment funds

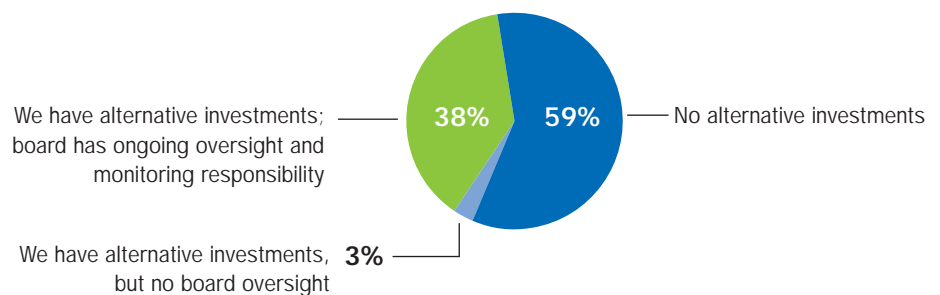


### What is your board's level of oversight of alternative investments?

Four out of 10 (41 percent) of organizations have alternative investments. Of these organizations, 38 percent say the board has oversight.

The board or its investment or finance committee should be involved in up-front due diligence before an investment is made. It should also perform ongoing monitoring to ensure that not only are these alternative investments properly valued, but also that the investments exist and have been valued accurately. Organizations should also visit the investment managers and ensure that the information received from these managers is timely and as detailed as possible.

Board oversight of alternative investments



## Alternative investments: Mitigating potential risks

Over the past several years, many not-for-profit organizations have invested in alternative investments, which may offer higher returns than more traditional investments, but often at a higher risk.

Boards, finance committees and investment committees are expanding their due diligence procedures relating to their initial investment in alternative investments, as well as the ongoing monitoring of such investments. In addition, management teams are enhancing financial reporting and monitoring controls to improve oversight of alternative investments.

### Initial due diligence

Prior to investing in alternative investments, not-for-profit organizations need to conduct extensive, documented due diligence and ensure adequate discussions are held at the board, committee and management levels. The following represent several of the initial due diligence procedures that should be considered:

- Assess the reputation of the individuals who manage the alternative investments.
- Visit the offices of the general partners/investment managers to see their operations.
- Request references from other investors, including not-for-profit organizations that have invested in these alternative investments.
- Ensure that the alternative investments are audited at least annually by a reputable and recognized external auditing firm.
- Determine whether the investment managers/general partners engage their external auditors to prepare a Statement on Auditing Standards (SAS) 70 report, which is a third-party review of internal controls. Obtain the two most recent SAS 70 reports, if available.
- Obtain information on the investment managers'/general partners' investment strategies, policies and operating procedures.
- Review and understand the valuation procedures employed by the general partners/investment managers.
- Obtain copies of all legal agreements and other related documents for the alternative investments under consideration, including offering memorandum, legal agreements and Form ADV (used by advisers to register with the Securities and Exchange Commission as investment advisers).
- Determine whether additional future investments will be required as part of a multi-year investment commitment.

- Assess what exit strategies exist to avoid the need for future investments or to liquidate existing investments should there be poor performance.
- Assess whether the alternative investments will generate unrelated business taxable income, which would require the organization to file a Form 990-T with the IRS and, possibly, related state filings and to make quarterly estimated tax payments.
- Engage external, independent investment consultants to review the alternative investments under consideration and report observations and recommendations to the board, investment or finance committee and management.

### Ongoing monitoring

Continuous monitoring of alternative investments is critical to ensuring proper financial reporting and disclosure. Most importantly, ongoing monitoring helps protect an organization from a possible loss on alternative investments.

To ensure proper controls and monitoring, it is an important best practice for boards to establish a formal investment policy and an investment committee to monitor these investments. The investment committee should be composed of individuals with expertise in investment management and reporting.

Management should develop and continually update a detailed listing of alternative investments grouped by fund, manager or investment type. It is also important to ensure that organizations obtain and review audited financial statements of the investment funds, noting valuations and significant accounting policies.

Management should also monitor the level of ownership in a fund to determine the proper accounting method and should perform and document a periodic assessment of the financial statement risk of material misstatement of alternative investments.

With the increasing complexities of alternative investments and more sizeable positions taken by not-for-profit organizations in such investments, it is critical that organizations have proper policies, procedures and controls in place before making such investments. Procedures must also be implemented to monitor these investments. In addition, organizations need to be able to demonstrate to external auditors, through well-documented pre- and post-investment due diligence processes and procedures, the existence and proper valuation of these alternative investments.

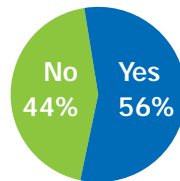
# Board responsibilities

## Are board members expected to make a financial contribution to the organization?

More than half (56 percent) of respondents say their board members are required to make a financial contribution to the organization.

Requiring donations from members of the board is a trend that could become increasingly expected in the near future. Many organizations employ a “give or get” policy where board members are requested to contribute personally and/or solicit contributions from their friends and contacts.

## Board contributions



If yes, how much of a contribution is expected on an annual basis? (By budget size)

	<\$20M	\$20M - \$50M	\$50M - \$100M	\$100M - \$500M	>\$500M
\$1,000 or less	54%	39%	39%	24%	25%
\$1,001 - \$2,500	20%	18%	15%	12%	12%
\$2,501 - \$5,000	12%	7%	22%	4%	25%
\$5,001 or more	14%	36%	24%	60%	38%

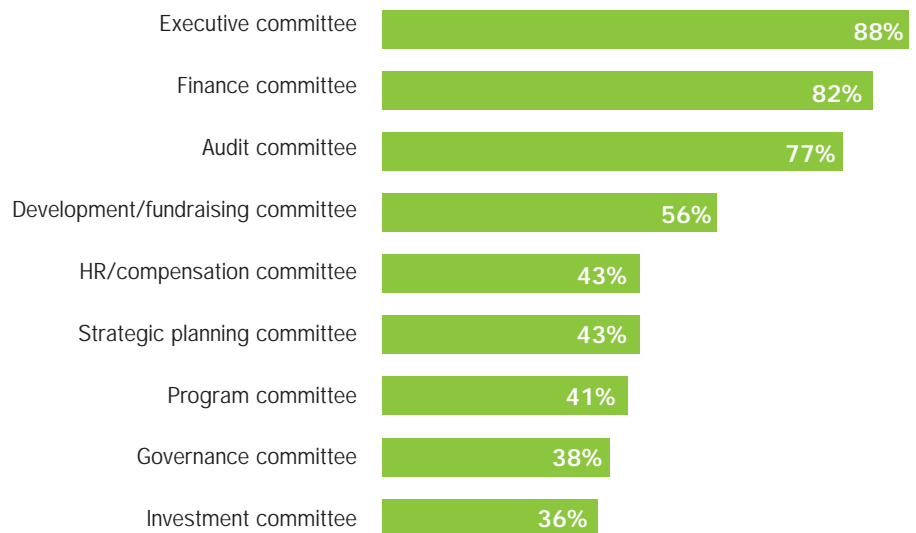
## Which of the following board committees does your organization have?

Boards appoint committees to focus on particular areas of board responsibility that deal with issues too detailed and/or numerous to be handled by the entire board. Committees capitalize on board members’ expertise, time and commitment and ensure diversity of opinions on the board.

Because committees are essential subsets of the full board, they can devote a good deal of time to an issue before bringing it to the full board, thereby maximizing the effectiveness of the time the full board spends on an issue.

Nine out of 10 (88 percent) survey respondents have an executive committee, compared to 83 percent in the 2006 survey, and 82 percent have a finance committee, an increase from 76 percent last year. More than three-quarters (77 percent) have an audit committee, up from the 64 percent who said they had such a committee in 2006.

## Board committees



For the first time, the survey asked if organizations have a strategic planning committee. More than four out of 10 (43 percent) do have a strategic planning committee in place, an effective way to

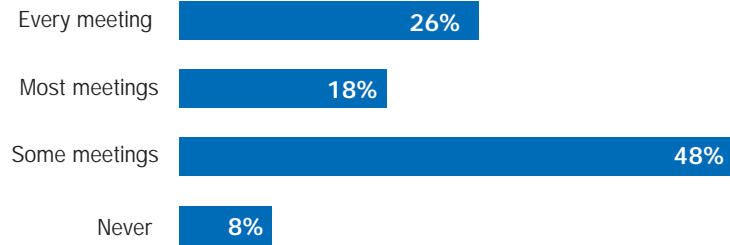
oversee an organization’s long-term goals, outline how it will achieve certain results and alter the course of action should the organization’s goals change.

**How often does your board meet in executive session?**

An executive session is the portion of a board or committee meeting during which non-board members, including members of management, are excused and board members have an opportunity to discuss issues with fellow members in a comfortable, open environment — free from other constraints.

Consistent with last year’s findings, almost half (48 percent) of the survey respondents’ boards meet in executive session during some meetings and more than one-quarter (26 percent) meet in executive session every meeting. Fewer organizations’ boards, however, never meet in executive session (8 percent this year, compared to 14 percent in the 2006 survey).

Executive session



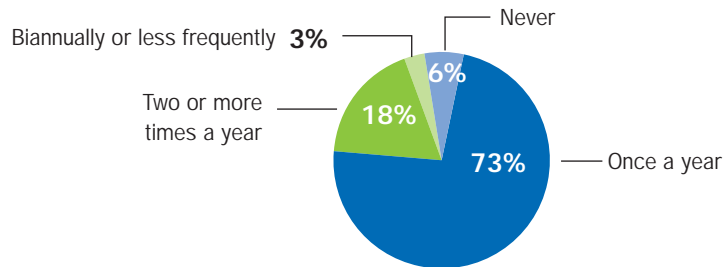
Incorporating an executive session into all board and committee meetings as part of the standard agenda is considered a best practice. Regularly scheduled executive sessions avoid causing undue stress to management and other constituencies because they are routine, rather than held because of a particular concern or issue.

**How often does your board or appropriate board committee meet to discuss executive management’s compensation and benefits?**

The boards or compensation committees of 73 percent of organizations discuss executive compensation and benefits once a year. Surprisingly, six percent of respondents say their board never discusses executive compensation.

Board discussions are paramount to ensure the organization’s compensation and benefits are in line with its peers and in compliance with IRS standards, including the intermediate sanctions rules. Disclosure of compensation to the full board, in executive session if necessary,

Executive compensation discussions



should be seen as a key board responsibility. Recent scandals have been particularly embarrassing to organizations when board members learned the details about their chief executive officer’s compensation for the first time in the press.

## Compensation oversight: Is your organization doing enough?

Improper handling of executive compensation has damaged the reputation of many not-for-profit organizations. The IRS monitors not-for-profit organizations and can impose intermediate sanctions for unreasonable salaries and benefits or for other transactions between the organization and its insiders, in which the insiders receive more than what the goods or services they provide are worth.

The test is whether the amount provided to the insider (generally a trustee or staff member) exceeds the fair value that the organization receives. The IRS can impose a monetary sanction in cases of improper dealings involving organizations exempt under sections 501(c)(3) and 501(c)(4) of the Internal Revenue Code.

The IRS can also impose a penalty on “automatic” excess benefits, which can happen inadvertently by incorrect tax reporting of compensation or certain fringe benefits as tax-free, or by incomplete record keeping for the insider’s use of the organization’s assets and other expenses.

In addition, board members who knowingly and willfully approve such a transaction are jointly and severally liable for a 10 percent tax, up to \$20,000 for each transaction.

Insiders covered by the law include persons who have a substantial influence over the organization’s affairs. These include members of the governing body (the board), the chief executive officer and chief financial officer, and others who it is determined have such influence.

Organizations should have procedures in place to prevent conflicts of interest, excessive dealings with disqualified persons and incomplete tax reporting. D&O insurance policies may or may not cover these penalties.

The board, or a committee that has no conflicts of interest with the person whose transaction is under consideration, should approve all transactions involving insiders. All compensation and benefits should also be properly disclosed on the Form 990 and, if taxable, reported on Form 1099 or Form W-2, as appropriate.

### IRS compensation review

Recently, the IRS reviewed the compensation practices of approximately 2,000 not-for-profit organizations to observe compensation practices, increase awareness of compliance issues and enhance reporting and tax law compliance.

Of the 2,000 organizations reviewed by the IRS, 1,200 compliance check letters were sent, 800 organizations were audited and 115 received warnings and will be monitored. In addition, 49 percent were asked to provide more information and 31 percent filed amended returns, resulting in \$21 million in proposed taxes.

To be prepared in case of an IRS inquiry, all organizations, regardless of size, activity or good works, should inventory their tax positions and tax reporting documentation. Planning, analysis and documentation are essential in this process.

As part of the process, the board or compensation committee should actively review the compensation of key employees and other “disqualified persons.” The purpose of this review is to ensure reasonableness, correct tax withholding and reporting and full and proper disclosure.

The review should include contractual compensatory items such as base salary, bonuses and retirement/welfare benefits as well as non-written benefits and perks provided. It should also include a review of expense reimbursements to make sure sufficient documentation is on file to support the business purpose.

With pre-planning and ongoing documentation, your organization will be positioned to offer information about all of its tax positions, including executive compensation, before being asked.



## The audit committee and the internal audit function

### If your organization has an audit committee, who does it include?

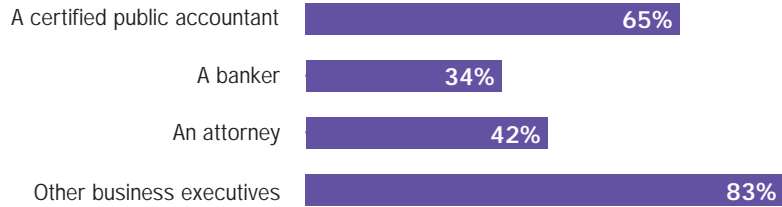
Sarbanes-Oxley encourages at least one financial expert be included on public company audit committees. While not-for-profit organizations are not required to follow this same standard, one or more financial experts with professional knowledge of financial reporting (including generally accepted accounting principles), business risk assessment and internal control practices is critical to ensure an effective audit committee. Ideally, there should also be individuals on the committee with specific knowledge of not-for-profit accounting and business issues.

Two-thirds (65 percent) of respondents say their audit committee includes a certified public accountant — consistent with last year’s findings. More than four out of 10 (42 percent) include an attorney and one-third (34 percent) include a banker on their audit committee.

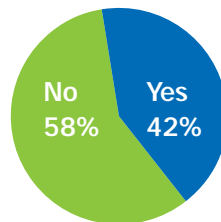
### Does your auditor meet with the full board of directors/trustees?

More than four out of 10 (42 percent) survey respondents say their auditor meets with the full board. As a best practice, the organization’s audit partner should attend a full board meeting annually or biannually to briefly present the audit results and be available for any questions. While the board usually delegates responsibility for the financial audit to the audit committee, that delegation doesn’t abrogate the board’s fiduciary responsibility.

If you have an audit committee, does it include...



Auditor meeting with the full board of directors/trustees

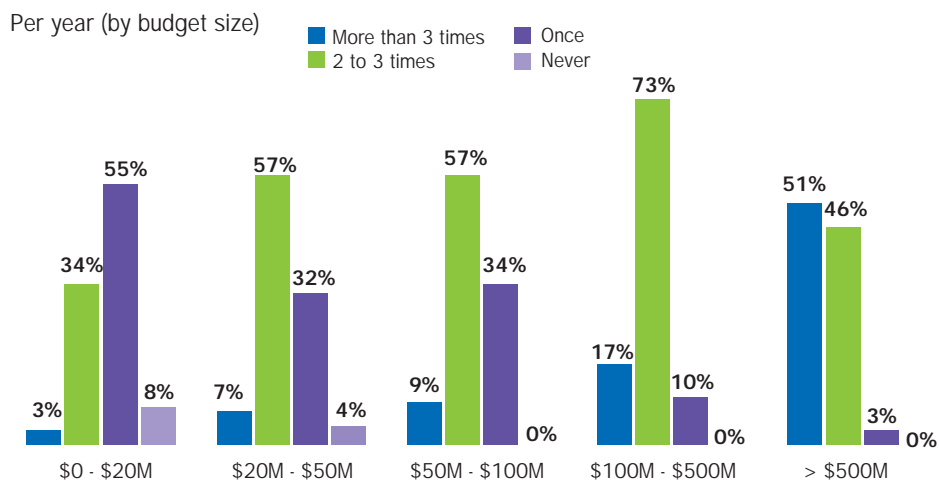


### How often does your audit committee or appropriate board committee meet with your auditor?

Audit committees are meeting with the organization’s auditor more frequently. Forty-six percent of survey respondents meet with their auditors two to three times a year, compared to 38 percent in 2006. And 5 percent say they never meet with their auditors, a decrease from 10 percent last year. Under U.S. generally accepted auditing standards, auditors are required to report the results of their audits to the governing body of an organization.

More than half (55 percent) of organizations with budgets of up to \$20 million meet with their auditor once a year, while those with budgets of \$20 million to \$50 million (57 percent), \$50 million to \$100 million (57 percent) and \$100 million to \$500 million (73 percent), meet with their auditors two to three times a year.

Frequency of auditor meeting with audit committee



The majority (51 percent) of audit committees of organizations with budgets of more than \$500 million, however, meet with the auditor more than three times a year.

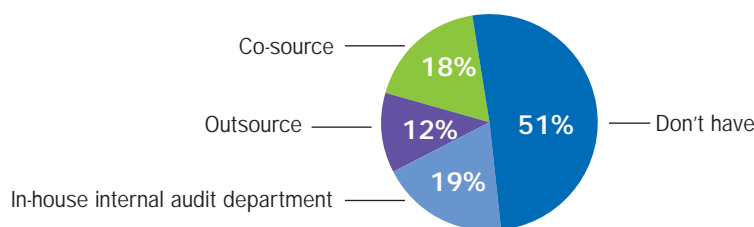
To be effective, audit committees should meet with their auditors at least twice a year: once to review the plan for the external audit and again to receive the results of that audit.

### Which best describes your internal audit function?

Of the 49 percent of organizations with an internal audit function, 19 percent have an in-house department, 12 percent outsource the internal audit function and 18 percent co-source — a combination of an internal and outsourced function.

Today, audit committees are expecting more from their internal audit functions or establishing such functions where they didn’t previously exist. Internal auditors often provide much broader support for an audit committee than can the external auditors. Internal auditors can evaluate and monitor an organization’s risk management beyond the risk associated

Internal audit function



with external financial reporting, assess the quality of internal financial reporting, and determine how effectively the organization is complying with the full range of governmental and professional regulations.

## The importance of the internal audit function

The trend in the not-for-profit sector is increasingly moving toward making internal audit functions more robust or establishing such functions where they haven't existed in the past.

The trend can be attributed to many factors, including the following:

1. The passage of Sarbanes-Oxley. Many board members who work at publicly held companies have experience with Sarbanes-Oxley or see it as a model of good organizational behavior. Sarbanes-Oxley mandates a review of all transaction sub-cycles that affect financial reporting.
2. The increasing use of what is called the "COSO model" of assessing risk within an organization. COSO is the Committee on Sponsoring Organizations, which is an umbrella organization for trade associations concerned with improved risk management and internal controls. The COSO model emphasizes assessing three dimensions of risk:
  - a. Financial reporting
  - b. Compliance
  - c. Operations
3. The never-ending reporting of various corporate and not-for-profit scandals and alleged improprieties, which fosters public mistrust of organizations, including not-for-profits. Board members and management want to take all reasonable steps to protect their organization's reputation and avoid any unflattering attention.

As a result of these trends, audit committees are redefining their roles beyond the oversight of the auditor and the financial statement audit. Increasingly, they see their role as one of assessing the organization's business risks and making certain that the organization has adequate internal controls in place to mitigate those risks.

The internal audit function provides the audit committee with an organized process for evaluating the effectiveness of internal controls over the key risks of the organization. The internal audit function is supervised by the audit committee rather than by management so that it can be independent of — as well as critical of — internal policies, procedures and controls, if necessary.

When the overall business risks of an organization are assessed through the COSO framework, the audit committee begins to see the internal audit function more broadly and identifies issues such as endowment management, grants and contracts, executive compensation and expense reimbursements, fundraising and information technology security. These are the activities that could cause significant financial loss or reputational damage.



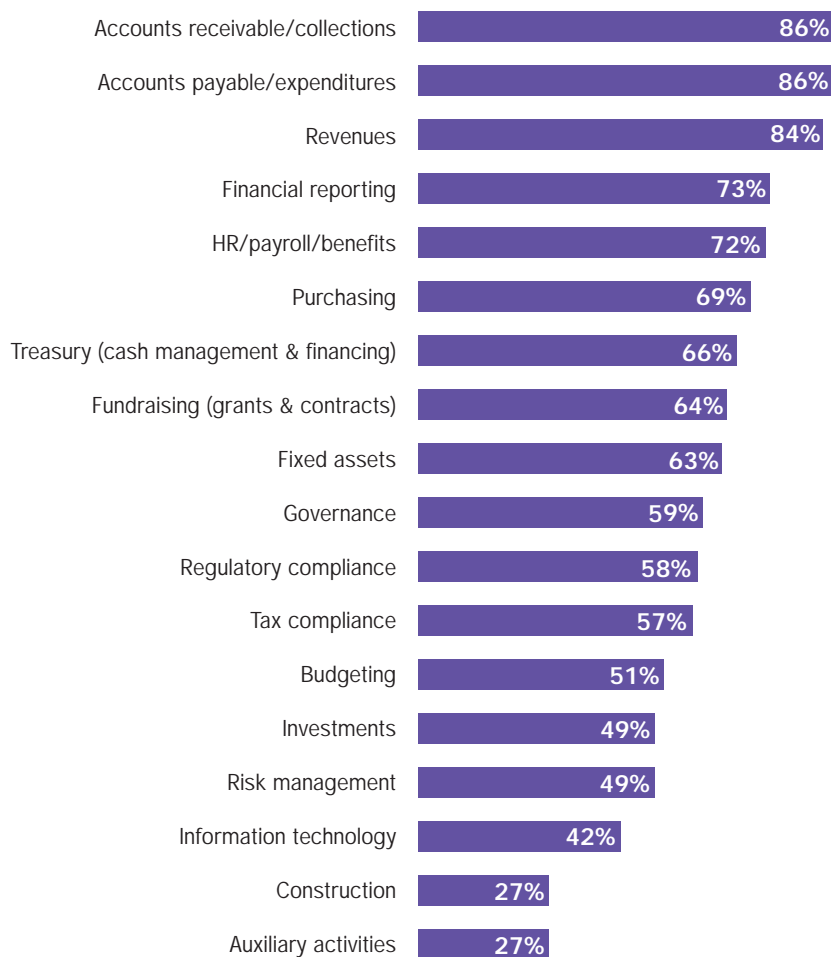
### Which of the following organizational activities does the internal audit function audit?

More than eight out of 10 organizations with an internal audit function say their internal auditors audit accounts payable/expenditures (86 percent), accounts receivable/collections (86 percent) and revenues (84 percent).

Fewer than six out of 10 respondents indicated that their internal auditors review governance activities (59 percent) and regulatory compliance (58 percent) – areas of importance to an organization’s transparency and accountability.

Organizations should consider moving beyond the traditional concept of the internal audit. In addition to governance and regulatory compliance, areas such as investments (49 percent), risk management (49 percent) and information technology (42 percent) should be considered for possible internal audit.

### Activities audited by the internal auditor



### Higher education institutions



## Independence and accountability

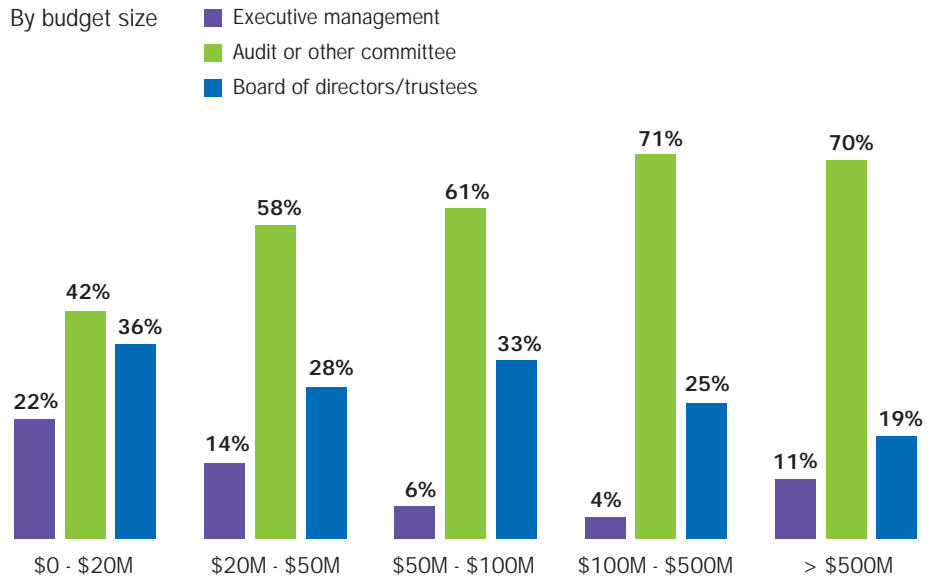
### Who in your organization is responsible for hiring and terminating the audit firm and determining the scope of work?

Under Sarbanes-Oxley, the audit committee or the board is responsible for hiring and overseeing the work of the external auditor. Although not-for-profit organizations are not required by law to follow this policy, the majority (52 percent) say the audit or other appropriate committee manages this process, an increase from 40 percent in 2006.

For the first time in the survey’s history, the audit or other appropriate committee is largely responsible for these duties for organizations of all budget sizes. These findings illustrate that Sarbanes-Oxley is having a significant impact on not-for-profit governance.

### Engaging the audit firm

By budget size

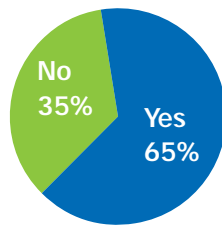


### Has your audit committee established a policy requiring its pre-approval before engaging the audit firm to perform any special projects beyond the scope of the audit?

The independence of an organization’s auditor is the foundation for a quality audit. If the auditor engages in non-audit activities, there is the potential that the auditor’s independence can be compromised, either in appearance or in fact.

Having audit committee pre-approval for work outside the scope of the audit demonstrates that the board and its audit committee are the auditor’s client. Two-thirds (65 percent) of survey respondents require audit committee pre-approval of non-audit services, an increase from 53 percent in 2006.

### Special project pre-approval



This upward trend is partially in response to the intense focus on auditor independence in the not-for-profit sector over the past several years.

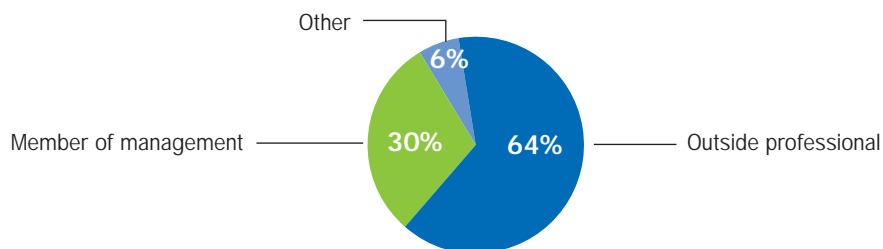
### Who prepares your organization's Form 990/990-T?

The Form 990 is the required IRS tax return for not-for-profit organizations and is a public document receiving increasing attention by the press and by watchdog agencies.

Almost two-thirds (64 percent) of survey respondents indicate that their organization's Form 990/990-T is prepared by an outside professional.

On June 14, 2007, the IRS released a new and improved Form 990 draft, which was completely redesigned in an effort to substantially enhance its value as a compliance tool and to provide pertinent information to the public. The revisions to the return will likely continue to spur the trend of organizations outsourcing the preparation of their Form 990/990-T.

Form 990/990-T is prepared by...

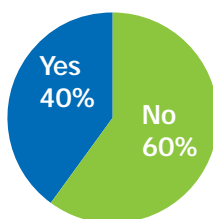


### Does the audit committee, finance committee or full board review the Form 990/990-T?

Only four out of 10 survey respondents say the audit committee, finance committee or full board reviews its Form 990/990-T.

The Form 990/990-T is the most public financial document available with respect to any particular not-for-profit organization. From a best practice perspective, at least one of these committees or the full board should review the Form 990/990-T to ensure all information is presented correctly and in accordance with IRS regulations.

Form 990/990-T review



## Hiring and working with the external auditor

One important way that the board, through its audit committee, fulfills its fiduciary responsibilities is through the hiring, oversight and, when necessary, termination of the external auditor.

The external auditor provides the board with an independent assessment of an organization's financial statements and the design effectiveness of the organization's internal controls over financial reporting. The external auditor should also be expected to serve as a business adviser to the board and to management.

Your organization's audited financial statements are intended to give the board, donors, granting agencies, banks, watchdog organizations, bond rating agencies and other constituencies an accurate picture of the financial position, changes in net assets and cash flows of the organization.

To fulfill those responsibilities effectively, the external auditor should be hired and evaluated by the board, through its audit committee. Such a process results in an external auditor being independent of management, so that the board can have a professional and expert evaluation of the quality of management's external financial reporting.

The criteria the board should use in evaluating auditors include:

### 1) INDUSTRY EXPERTISE

The not-for-profit sector has a variety of specific accounting requirements that an auditor should know intimately. The auditor should be able to demonstrate success in auditing many not-for-profit organizations and be able to bring best practices to your organization.

### 2) TAX CAPABILITIES

The firm should have a strong tax specialty in the not-for-profit area. Not-for-profit organizations are subject to many unique tax regulations that change often. Because an organization's tax-exempt status is critical, it is vital that the firm understand relevant tax issues.

### 3) MANPOWER, TRAINING AND SCHEDULING

The auditor should have sufficient staff to do the job, and should understand the intricacies of not-for-profit accounting. Your own financial staff should not be training the auditor's staff in the basics. The audit team should also perform the audit in accordance with the schedule your organization and the auditor have agreed upon.

### 4) DEPTH OF EXPERT RESOURCES

The firm should have the depth of expertise to provide its own staff and your organization with information and experience that provides critical business advice to improve your organization's operations.

### 5) PRICE

While price should not be the sole determining factor in your auditor choice, it is certainly a consideration. Be sure to evaluate both what the auditors propose to do for their fee and their ability to serve the special needs of your organization, but also remember the old adage, "You get what you pay for."

### 6) CHEMISTRY

The audit committee, management and people throughout your organization will all have to work closely with your auditors. The personal chemistry between key personnel in your organization and the external audit team is very important.

Your external audit firm should be expected to meet these criteria on a consistent basis. You have every right to expect trained staff, timely execution of the work and good business advice based on industry and accounting expertise.



## Appendix

### About Grant Thornton

Grant Thornton LLP is the U.S. member firm of Grant Thornton International, one of the six global accounting, tax and business advisory organizations. Through member firms in more than 110 countries, including 50 offices in the United States, the partners and employees of Grant Thornton member firms provide personalized attention and the highest quality service to public and private clients around the globe.

Grant Thornton 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, cultural organizations and foundations.

As a member of one of the largest international accounting and business advisory organizations, Grant Thornton offers a complete array of services designed specifically to help our not-for-profit clients meet their assurance, 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.

*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.

For more information on the survey or Grant Thornton's not-for-profit industry practice, visit our website at [www.GrantThornton.com/nfp](http://www.GrantThornton.com/nfp).

### About the Board Governance Institute

The Board Governance Institute is Grant Thornton's one-stop e-resource to keep board members and executive management of not-for-profit organizations abreast of current and emerging business issues such as accounting, tax, regulatory, governance and operational issues.

Not-for-profit professionals can also stay in tune with the industry's latest trends through the Board Governance Institute's Education Forum, which provides board members and management of not-for-profit organizations educational opportunities to enhance professional development, business

acumen and not-for-profit industry expertise.

The Education Forum features complimentary seminars and roundtable sessions presented by Grant Thornton not-for-profit professionals and other industry experts on topics related to board governance issues, legislative and regulatory updates, tax updates and business, accounting and financial matters.

Visit [www.GrantThornton.com/bgi](http://www.GrantThornton.com/bgi) to access the Board Governance Institute, register for the Education Forum and receive information about upcoming seminars.

## About the survey

Grant Thornton conducted the fifth annual *Grant Thornton National Board Governance Survey for Not-for-Profit Organizations* Sept. 5 to 24, 2007.

Responses to the web-based survey were received from 603 chief executive officers, chief financial officers, 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.

Respondents cover 47 states and the District of Columbia.

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

## Survey respondents

### Industry

Social or human services organization	20%
Trade or professional association	14%
Higher education	14%
Health care	13%
Education	8%
Cultural organization	6%
Research or scientific organization	5%
Foundation	4%
Religious organization	3%
Other	13%

### Organizations' total annual budget

< \$20M	52%
\$20M - \$50M	19%
\$50M - \$100M	11%
\$100M - \$500M	12%
> \$500M	6%

### Title

Chief financial officer/finance director	34%
President/chief executive officer/ executive director	23%
Board member/treasurer/ finance or audit committee chair	13%
Controller	9%
Chief operating officer	5%
Director of internal audit	2%
Other – (e.g., vice president of administration, general counsel, mid-management level)	14%

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