Higher Ed

Higher education board guidebook

Contents

The higher education board member's guide to directing your institution toward its mission

College and university board of trustee members have a critical responsibility: To direct the institution toward achieving its mission. As a trustee, you have the opportunity to contribute your talent, expertise and dedication to a worthy cause.

Serving on the board of a college or university, particularly a highly visible one, is both an honor and a responsibility. As a trustee, you must remain focused on providing good stewardship of the institution's mission, reputation and resources. The responsibility that comes with providing this stewardship need not be overwhelming; when you begin your board tenure with a solid overview of what you need to know and what will be expected of you, your orientation to trusteeship should go smoothly.

As you read through this guidebook, you may uncover questions you didn't know you had. Grant Thornton LLP's Not-for-Profit and Higher Education professionals have the answers. We're committed to providing outstanding service to meet all of your accounting, tax and advisory needs.

We welcome your feedback and are available to assist you in addressing the challenges your board and your institution may face.

Dennis Morrone
National Managing Partner
Not-for-Profit and Higher Education Practices

Trustee roles, responsibilities and liabilities

Once a trustee has been selected, it is important that he/she be brought up to speed as quickly as possible on his/her new role and responsibilities.

New trustees should receive a briefing from the chair and a tour of the institution's facilities. Further, institutions should offer a formal board orientation program covering such topics as how the board functions, management duties versus board duties, indemnification and insurance, institutional finances and operational/academic performance metrics, goals and strategies, confirmed fundraising expectations — which should be communicated prior to joining — board committees, information flow, delegation and authority.

Ideally, the institution should make available a board orientation book or other sourcebook containing the following information:

- The institution's articles of incorporation, bylaws and amendments
- A statement of the institution's history, mission and services
- The institution's strategic plan
- Regular financial and operating reports from the past year
- The most recent audited financial statements, including the management letter as applicable
- A copy of the directors' and officers' (D&O) liability policy
- A copy of the code of conduct policy
- Contact information of fellow trustees and key administrators
- Biographies of fellow trustees
- A list of the institution's key executives
- Rules about expense forms and reimbursement
- A calendar of the upcoming year's board and committee meetings, including dates, times and locations
- A list of committees and committee assignments
- Minutes of board and committee meetings held within the past year
- The conflict-of-interest policy and summary of related disclosures
- Copies of any recent regulatory filings, including Form 990
- Results of any governmental audits or regulatory reviews

While it is not necessary to be conversant with all the information detailed above — given its considerable volume — trustees should be aware of the book's contents and know when to consult it.

Roles of the board

The board should be focused on certain key responsibilities that are essential to its success:

Preserving, reshaping when necessary, and achieving the institution's mission, vision and values

This is one of the board's most important roles. Trustees need to make certain that a strategic plan is in place describing how the institution will fulfill its mission going forward. In addition, trustees should measure each proposed action against both the institution's mission and its approved strategic plans.

Selecting the president

Another important role for the board is the selection of the president, to provide full-time leadership for the institution and to recommend and implement the policies and programs approved by the board. Regular evaluation of presidential performance is also critical. Sometimes the board's responsibility will include confirmation of those nominated for key positions by the president.

Ensuring that the institution is well-managed

While the board should not manage the institution, it should be satisfied that the institution is managed effectively. The board should ask enough questions to satisfy itself that a sufficient number of qualified staff members are assigned to key tasks, resources are allocated through a realistic budget consistent with the mission, internal controls are in place to prevent fraud or noncompliance, proper ethical and governance standards are followed, the programs of the institution have clearly defined purposes, and the purposes are being achieved.

Setting the tone at the top

The board needs to be clear and unequivocal in its commitment to holding itself and management to the highest fiduciary and ethical standards. It must communicate this commitment to the entire college/university community. In virtually all cases of institutional fraud or malfeasance, a strong contributing factor is the lack of such clarity from leadership.

Representing the external world to the institution and the institution to the external world

Trustees must serve as a bridge to the community. Trustees advocate on behalf of the institution, helping to raise awareness of its mission, often by being involved in the solicitation of major donors and advocacy to key constituents. It is also important for the board to be sensitive to the environment in which the institution operates. In that capacity, the board can serve as an important conduit by receiving the institution's staff feedback about how policies, plans and programs are perceived and how they need to adapt in response to a changing world.

Protecting the institution from external threats

In the lives of many institutions, issues arise that threaten the autonomy, services or good name of the institution. Such issues include scandals involving the institution — or similar institutions — or political attacks on the purposes or programs of the institution. In these circumstances, trustees need to step forward to explain and defend the institution. Other external threats are economic, regulatory, legislative and competitive. While these often cannot be controlled or mitigated, it is the trustees' responsibility to make sure the institution has fully considered these threats and is prepared to respond accordingly if they were to occur.

Overseeing assets

In serving a nonprofit entity, it is the duty of the trustees to ensure that the use of institutional assets — which are held in trust for a specific charitable or educational purpose — is consistent with the institution's mission, regulatory requirements and accepted accounting principles.

Exercising financial stewardship

As it relates to financial assets, the board is responsible for approving the budget and challenging assumptions as well as major financial transactions that affect net assets — both those with and those without donor restriction — such as the issuance of debt. The board also provides oversight of the endowment management policies and processes, usually through an investment committee, and approves the goals of fundraising campaigns. In addition, the board tends to play a major role in supporting capital campaigns by donating personal time and financial resources.

Approving key policies and practices

While it is up to management to write key governance-related policies (e.g., compensation and benefits, and conflicts), it is the responsibility of the board to make sure such policies are approved, in place, up-to-date and adhered to.

Ensuring that appropriate succession plans are in place for management

The board should ensure that management has developed succession plans for all key members of senior leadership.

Reviewing results achieved by management

The board is responsible for assessing senior leadership's efforts and progress toward efficiency and effectiveness improvements that support achievement of operational, strategic and mission goals. To assess the institution's overall performance, reviewing key performance indicators (KPIs) is critical in gauging progress toward attainment of institutional goals.

Minimizing risk of fraud or conflicts of interest

With competition for both students and funding at a high level, and legal and public scrutiny showing no signs of diminishing, the board must be particularly fierce in its fiduciary responsibility regarding guardianship of institutional assets and reputation. Conflicts of interest — in fact or perception — on the part of board members or management in conducting business with outside parties cast doubt on the fairness of the institution's transactions. Fraud not only costs the institution in lost assets, but also there is a multiplier effect in the downstream consequences of lost confidence in funders, regulators and key constituents (parents, students, faculty, etc.).

The board must promote a continuous emphasis on culture and ethics, as well as ensure that sound policies and internal controls are in place. It is the responsibility of the board to review and identify any relationships that could signify potential fraud or create conflicts of interest.

Protecting the reputation of the institution

Reputation can be affected by financial, operational and academic decisions, as well as by behavior of the staff, faculty and students. Assuring that the right disciplines to prevent reputational harm are established and maintained is the responsibility of the board, which has accountability for the actions and inactions of the institution. Effectively managing reputational risk should be viewed to be as important as executing the strategic plan, because mission achievement can be severely compromised by actions that erode the institution's reputation.

Being certain the board has the right skills and practices to do its job

The board needs individuals with a strong commitment to the fundamental purpose and mission of the institution. The board should consider performing an annual inventory of talent to assess whether the right professional capabilities are represented.

The board should also include individuals with the specific skills and know-how needed to examine issues through multiple lenses — legal, financial, public relations and communications, management, and professional development, among others. The board must also be attentive to its internal processes, so that its meetings focus only on board-level matters and do so in a way that draws upon the combined knowledge and experience represented at the table.

In addition to placing qualified individuals on the board and having a strong onboarding program, there should be a commitment to ongoing development of trustees in terms of key skills (e.g., fundraising, technology) and knowledge of institutional operations and industry best practices.

Making sure the institution is in compliance with laws and regulations

Being exempt from most taxes does not mean that the institution is exempt from regulation. Far from it. The board should be aware of federal and state laws and regulations that apply to the institution, along with applicable standards set by accreditors, bond covenants and charity watchdog groups amongst others.

Duties of an individual trustee

Your service as a trustee will be most rewarding to you, and you will serve the institution best, if you are able to focus on your key duties:

Attend all meetings

The skills you bring to the table do not matter if you are not present. Trustees who repeatedly miss meetings should be candidates for removal. Their absence can drain the morale of other trustees — and ultimately the morale of others in the institution.

Be prepared and informed

Before each meeting, read the meeting materials provided to you. Come prepared to ask questions and share perspectives. Stay informed of trends and developments in the type of work that the institution performs so that you can bring a broader perspective. In addition, stay abreast of good governance practices as they evolve.

Speak your mind and ask tough questions

Some institutions have suffered because trustees were more concerned about appearances than they were about discussing difficult or challenging issues. But you must address them when they arise. As a trustee, your primary responsibility is to protect the good name of the institution and to ensure that the institution's staff and resources are being used in a manner consistent with good practice in support of the institution's mission.

Take responsibility for your stewardship of the institution's assets

The board must make certain that use of funds is aligned with the intent of those who have donated them. Furthermore, the board must satisfy itself that sufficient funds are allocated to each function and that those allocations are in concert with its own priorities.

Watch others at the table

Check to make sure other trustees are pulling their weight. If not, this must be brought to the attention of the board chair, the committee chair, if applicable, and the nominating committee. In such circumstances, the best outcome is one where upon notice, the trustee steps up appropriately. However, there are times when the trustee must acknowledge that other activities in his/her personal or professional life are taking priority over his/her board commitment, in which case it is best for the trustee to step down and be replaced by someone who has the time and interest to be fully engaged.

While differences of opinion on the board are quite healthy, once a decision is reached, it is vitally important that all trustees align with and support the outcome of the discussion. Only when the full board acts in cohesion can the institution's mission be fully accomplished.

Commit the time required to be effective in your role

Every trustee must be willing to devote his or her energies to the institution by dedicating time to board and committee work, participating at events and being vocal at meetings. They must share experience, expertise and opinions.

Remember that integrity is paramount

The most important asset of your institution is its reputation. The second most important asset is the confidence of your donors in the institution's capacity to prudently manage and spend funds. The board should make certain — in both its own practices and policies, and those of the staff — that integrity remains the highest priority. If the board sets a good example, the institution will most likely follow it.

Be a representative of the institution

As a trustee you must represent the institution to the community, and through your board participation, endorse the institution's mission.

Contribute your dollars in addition to your time, skills and experience

Donate a quality gift to the institution annually and, to some degree, participate in the donor development process (give as well as get).

Take responsibility for a specific initiative or activity

Every trustee should, at some point after he/she becomes acclimated to the role, take ownership of a key task, committee, event or other board undertaking. Being a member of the board means more than just showing up to board meetings or making a contribution (as important as both those activities are). A high-performing trustee needs to roll up his/her sleeves and be responsible for doing something. There is a lot of work to be done by the board, and it is important that the workload be equitably shared among its members.

Critical distinctions

Board vs. management

Both the institution's board and its management must have a clear understanding of the distinctive roles that each group plays. Much confusion — and sometimes conflict — occurs when those distinctions aren't clear. Trustees do not have individual power or authority. Instead, these powers reside with the full board and its committees. It is up to management to do and to the board to guide, review and approve/endorse. The board sets standards to measure how well management performs — and initiates actions, when necessary, to see that management carries out its obligations.

For institutions that struggle with the issue of engagement versus oversight, development of an authority matrix may be a useful tool in delineating policy-driven responsibilities and decision-making.

Committees vs. the full board

Most of the board's work should be done by its committees. Thus, individual trustees will become knowledgeable in key areas of the board's work, and the full board will spend less time on any one issue or set of issues. It is good practice to follow a committee's recommendations unless there are compelling reasons not to do so.

The board as a whole should not reprocess work done by committees. A trustee should not expect or request enough information from a committee to reach a similar conclusion. Rather, the trustee's responsibility is to be satisfied that an appropriate and adequate process was followed.

Board committees are likely to include governance (sometimes included with nominating or audit), finance, audit, investment, executive, development/fundraising, HR/compensation and nominating.

The external auditor is accountable to the board, not to management

Commissioning an external audit by a qualified public accounting firm is a key element of the board's responsibility. The accounting firm should be selected by the audit committee on behalf of the board and should present the audited financial statements to the committee and/or the full board. Grant Thornton's *Higher Education Audit Committee Guidebook* provides further information.

Boards typically reserve these functions for themselves:

- Setting broad policy principles, approving specific major policies
- Approving new programs and/or terminating old ones
- Reviewing and approving institutional strategy and long-term financial goals
- Selection, oversight and compensation of the president
- Approval of the budget recommended by management
- Accountability for the integrity of financial reporting, controls and assessment of business risk
- Oversight of the endowment

Management is generally responsible for these functions:

- Development and execution of strategy
- Selection and supervision of staff
- Development, recommendation to the board and implementation of the budget
- Establishment of operating procedures

Liabilities

A trustee has a fiduciary obligation to the institution. He/she must act with good faith and loyalty — and always exclusively in the best interests of the institution.

Although trustees generally have limited liability for actions taken or not taken as a trustee, there can be liability if they fail to satisfy their duties of good faith, care and loyalty. Abuse of the good-faith presumption can result in financial liability to the institution and its trustees or in statutory liability.

A board has a legal duty to conserve and protect the institution's assets. This duty carries with it legal risk, which is why most higher education institutions carry D&O liability insurance. Most prospective trustees are aware of the potentially unfavorable consequences of board-related litigation; indeed, some will not sit on boards of institutions that do not have adequate D&O liability insurance. A new trustee should know the extent of D&O insurance coverage. It may be prudent for a trustee or the institution as a whole to have the D&O policy evaluated by independent legal counsel. For additional safety, some states have adopted volunteer-protection statutes for the benefit of uncompensated trustees who act in good faith. Board members may consider obtaining an individual umbrella policy, usually as a rider to their homeowner's policy.

Claims against individual trustees of a higher education institution can arise from multiple scenarios:

- Vendors claiming the institution failed to meet its obligations, such as dining services not having adequate facilities
- Employees claiming wrongful termination or other violation of their rights
- Governmental entities claiming waste of assets or violation of reporting regulations
- Environmental damage from toxic waste on property an institution acquires
- Service recipients claiming negligent supervision or improper selection of employees and volunteers
- Violation of regulations regarding lobbying efforts

Both federal and state regulations prohibit trustees from engaging in improper dealings with higher education institutions and from knowingly approving excess-benefit transactions involving the institution's insiders. Indeed, trustees taking such actions are subject to financial penalties. (For more information, see "Intermediate sanctions" in the "Accountability and integrity" section.) Likewise, conflicts of interest can be the basis of liability action against a trustee. If a trustee receives an improper or undisclosed personal financial benefit as a result of the institution's transactions, he/she may be liable to the institution.

The idea of personal liability should not frighten anyone away from board service, but it behooves trustees to familiarize themselves with the protection afforded at the federal and state levels — and by the institution itself — and to exercise care in decision-making.

Keeping the board effective

Managing the makeup, skills and education of the board is an ongoing process. Boards should not only consider their current composition, but also plan for future membership and leadership — and, at the same time, evaluate overall board effectiveness. The following are the ways they can accomplish this.

Recruiting, retaining and motivating good trustees

The institution's success depends in part on the board's commitment. While trustees are sometimes appointed by external agencies or elected by constituents, in most cases the board selects its new members directly. A key board responsibility, in those cases, is to recruit trustees who will help the institution achieve its mission and remain active in the board's work. The board should be attentive to ways to make board service exciting and rewarding, including formal recognition of achievement.

Providing continuity of board leadership

The board should have a succession plan — formal or informal — that identifies future board chairs, committee chairs and other leadership roles.

Balancing the skills of trustees

Optimally, each trustee should possess at least one of several essential skills — budgeting, financial management, investments, governance, fundraising, HR and legal matters — as well as a working knowledge of the academic programs of the institution. A key responsibility of the nominating committee is to make sure there is an adequate representation of all skills on the board.

Evaluating the board's effectiveness

The board should create processes to determine whether it is functioning effectively in support of the institution's purpose. The board should ask whether it is following the practices recommended here, as well as other practices that trustees collectively agree are important. The board should then develop one or more evaluation tools to facilitate the assessment.

In addition to assessing board performance as a whole, trustees may want to self-assess their individual performance/contribution. The board might also find ways to ask its various stakeholders, including the individual board members, to assess its effectiveness.

Committee members should review their charters annually to ensure they are doing all that is expected of them and nothing that is outside of their purview.

Committee member self-assessments and the chair's assessment of committee member performance can be useful in enhancing committee performance and as input for future committee or board assignments.

Managing the board's size

The size of a board represents a difficult balance between diversity of views and skills and the board's functional effectiveness. A board needs to be large enough to have an adequate variety of skills, experience and perspectives, and to not unduly burden any trustee with too many committees or assignments. Conversely, a board must be small enough to adequately engage each and every member, and to be agile in its ability to make decisions and react to changing circumstances, both internal and external. The larger the board, the more diverse its membership will be, but the less likely it will be to reach clear decisions quickly. Larger boards typically rely on committees to work through issues and to report to the full board.

Monitoring board continuity and turnover

Both continuity and turnover are essential features of good trusteeship practices. Continuity provides institutional memory. Turnover brings fresh perspectives. In general, it is good practice to set term limits for trustees.

Providing opportunities for education and orientation

The education of trustees should not be limited to their orientation. On a regular basis, time should be set aside to cover topics such as the predicted effects of pending legislation, tips for reading financial statements, key institutional activities and fundraising techniques for trustees, as well as for learning more about key departments of the institution. Periodically, the board should ask itself important questions: Are we true to our mission? Is our mission well-defined? Boards should also have annual retreats to discuss the alignment of the institution's mission with its goals.

Planning in advance of meetings

Efficient and effective meetings are essential to a well-functioning board. Boards should ensure that meeting agendas are planned well in advance. Consent agendas are being used more often to reduce the time spent on nonessential issues — that is, items that require formal board approval but for which there is no need for board discussion before taking a vote. The board meeting thus involves only the discussion of critical issues and the presentation of resolutions requiring a board vote.

Creating a culture of focus on both strategy and risk

The board needs to focus on the future of the institution and also on the risks that accompany its strategic objectives. Time should be spent on reviewing progress toward accomplishing the institution's strategic plan and toward monitoring and mitigating risks as identified in an ERM program.

Accountability and integrity

A trustee is a link between the higher education institution and the constituencies that support it and are served by it. Those constituencies are increasingly holding trustees legally and ethically accountable for the actions or inactions of the institution.

As we have noted, the most valuable asset that a college or university has is its good name, and a trustee's top priority should be protecting its reputation. Good practices, as well as the expectations of donors and regulators, require a high level of attention to the issues of financial reporting, controls and assessment of risk and accomplishment of mission. The board must be confident that adequate systems are in place for controlling, administering and planning the use of resources.

Policies

To mitigate potential risks, boards should consider instituting the following policies:

Code of ethics

Trustees should adopt a code of conduct that reflects high standards of ethical behavior that apply to the board, management and staff across the institution. Ensuring that this code is established and adopted is key to creating a proper tone at the top.

Conflicts of interest (and disclosures)

The board should have a conflict-of-interest policy that ensures the independence of the board, management, staff, the external auditor and other vendors, so that each entity performs only its role and is not compromised in any way. Conflict-of-interest confirmations should be completed by these parties at least annually, and any changes that could pose a conflict should be communicated and assessed in a timely manner between confirmations.

Whistleblower

The board should ensure that there is a policy in place for trustees, staff and other stakeholders to raise issues about the institution's ethical or financial practices. The policy should be linked to the institution's code of ethics and should clarify how to raise such issues, how to address them, and how to prohibit retribution for reporting concerns.

Intermediate sanctions

The IRS monitors higher education institutions and can impose intermediate sanctions for awarding unreasonable salaries and benefits or, alternatively, for allowing trustees or other interested parties to provide goods or services to the institution for more than they are worth.

The test is whether the benefit provided to the insider — generally a trustee, officer, key employee or substantial contributor — exceeds the value of the consideration the institution receives. This consideration can consist of services provided in exchange for compensation. The IRS can impose a monetary sanction in cases of improper dealings involving institutions exempt under Sections 501(c)(3) and 501(c)(4).

In addition, per the intermediate sanctions law, trustees who knowingly and willfully approve such a transaction are jointly and severally liable for a 10% tax, limited to $20,000 per transaction. Insiders covered by the law include persons who have a substantial influence over the institution's affairs. This could include members of the governing body (the board), the president and CFO, and others who are determined to have such influence.

Once someone is covered by this definition, family members and any controlled businesses he/she owns are also included. If the IRS imposes penalties, the details — including names and amounts — must be shown on Form 990 filings, which are available to the public.

As a trustee, you need to make sure the institution has procedures in place to prevent conflicts of interest and transactions involving excess benefits and disqualified persons, who, per the IRS, are those in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization at any time during the lookback period, which is the five-year period before the excess benefit transaction occurred. 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. The board should also make sure all compensation and benefits, including those provided to a trustee, are properly disclosed on Form 990. To the extent that these compensation and benefit amounts are taxable, they should be reported on Form 1099 or Form W-2, as appropriate.

Failure to properly document and report compensation and benefits is likely to result in automatic violations of these rules. Benefits that are paid or provided, but not properly reported and disclosed, are considered automatic excess benefits, regardless of the reasonableness of the amounts

Other regulatory/tax compliance issues

The board should ask management sufficient questions to satisfy itself that the institution is not violating laws or regulations made by the host of agencies that regulate the institution.

Of special importance to colleges and universities are the regulations and compliance issues related to the receipt of federal financial aid, sponsored research, and other types of federal funding. Penalties for noncompliance are significant and can lead to loss of both funding and institutional reputation.

An important tax issue is unrelated business income (UBI). The IRS will impose a tax liability on certain activities of a higher education institution if those activities are found to be business activities unrelated to the institution's tax-exempt purpose and not otherwise excluded from UBI in the Internal Revenue Code (IRC).

Higher education institutions may face other tax issues:

- State, local and foreign taxes
- Charitable registrations
- Foreign regulatory filings pertaining to investments
- Escheat and unclaimed property laws
- Excise tax on certain compensation greater than $1M
- Excise tax on endowments of certain colleges

Internal controls

Internal controls enable the board and the institution to perform several functions:

- Verify that transactions are properly authorized
- Ensure that assets are safeguarded
- Confirm that transactions are properly recorded and reported
- Prevent fraud and misstatements related to financial reporting

The board needs to ask questions and be vigilant about the effectiveness of the institution's internal controls and operating procedures. Areas under consideration should include receipt of funds, personnel and payroll procedures, authorization of disbursements, expense reimbursement, credit card usage, and handling of cash and investments. The board should ask questions about not only financial resources and personnel procedures, but also assets such as buildings, land, equipment and securities.

An effective internal control system will have a well-designed set of policies and procedures relating not only to transactions but also to record retention. Important files and information should be maintained and remain accessible for a reasonable period of time in accordance with local, state and federal statutes.

High-quality internal financial reporting

The board should expect to receive from management regular financial reports comparing financial results with budgetary estimates and reporting on the status of assets. The board should also expect management to make financial disclosures — consistent with the board's own reports — to trustees, contributors and other stakeholders.

To meet the board's need to evaluate the effectiveness of programs, many higher education institutions provide detailed internal statements that directly relate expenses shown on their financial statements to specific programs or functions. This functional approach makes it easier for trustees to analyze and evaluate costs.

A focus on KPIs, via a dashboard presentation, can be a very effective way for the board to keep its focus at an appropriate level of detail, concentrating on key financial and operational drivers, and trends in performance.

The external audit

To provide the board and the institution's other constituencies with confidence in the financial information and internal controls of the institution, the board should appoint a respected certified public accounting firm to conduct an audit of the financial records and processes of the institution.

The public accounting firm is responsible for providing the board with an independent opinion. Independence of both management and the board is an essential feature of good practice with respect to the external audit. Neither management nor trustees should attempt to influence the opinion of the public accounting firm.

Financial stewardship

While the corporate standard for success — profitability — may not be appropriate in higher education institutions, sound financial management is crucial to the vitality of every college and university.

Strong financial management is a necessary tool in competing for every dollar of tuition and fees, as well as for every contributed dollar.

An institution that is soundly managed is more likely to attract that dollar than one that is not.

Three aspects of financial management are of special concern to higher education trustees — budgeting, overseeing assets and raising revenue.

Budgeting and financial planning

The budget translates the hard-to-quantify goals of a higher education institution into measurable terms. It can be a powerful device for monitoring the institution's activities. This function is especially important because revenue shortfalls or uncontrolled expenses can sap the confidence of the institution's stakeholders and supporters.

Generally, the full board of an institution is involved only at certain stages in the budget process — establishing overall goals and activities that set the budget process in motion, approving the final budget, and comparing the institution's financial results with both its budget and its goals.

The board usually has a finance or budget committee that provides detailed oversight of these critical functions. This committee reviews management's recommendations — including key assumptions — for the next year's budget. Management performs most of the actual budgeting, with the CFO or budget director driving the process.

Committee members should ask difficult questions of both themselves and management:

- What priorities are reflected in the proposed budget?
- What trade-offs have been made?
- How realistic is it for us to expect to be able to raise X number of dollars in contributions or tuition this year?
- How realistic is it for us to expect the cost of doing business to increase by X%?

Not surprisingly, when difficult questions are asked, the budget may go through several revisions before reaching the full board. At that point, the extent to which the budget is further revised may vary widely from institution to institution. Sometimes boards are comfortable with making a decision based only on management's and the committee's recommendations, and many budgets require few changes by the full board. Even so, a board should be fully aware of the institution's financial condition.

To that end, it is the board's prerogative to ask difficult questions regarding the budget, to challenge assumptions and to request revisions as needed. Further, the board must compare the financial estimates and goals established in the budget with actual results, and seek to understand the cause for variances.

Overseeing assets

The audited financial statements provide a clear measurement of the institution's financial assets; therefore, the board should evaluate those statements closely. Any significant increase or decrease in assets should be examined in terms of the institution's overall effectiveness. The board should also find ways to assess the quality of the institution's human and physical assets, even though this is not reflected in the financial statements.

A financial asset requiring special attention by the board is the institution's endowment. The board should make certain that the endowment is overseen and managed in accordance with good practice and relevant state laws and should understand the reasons if its investment return differs from that of endowments held by institutions of comparable size and scope. The board should also satisfy itself that the institution's investment policy is consistent with the board's tolerance level for risk and volatility, and is reflective of institutional values.

Raising revenue

Most higher education institutions rely on fundraising activities to provide financial resources for their programs. Some institutions set minimum fundraising requirements for trustees; these standards are often referred to as give-or-get policies. For example, to remain on the board, a member would be required to raise $X annually through making personal contributions or soliciting them from others.

Institutional fundraising usually includes annual campaigns to support the operating budget and capital campaigns to raise funds for facilities and the endowment. Board involvement in capital campaigns is critical to the campaigns' success, with trustees providing personal leadership and making personal gifts.

The board must monitor both the management of donated funds and the cost of raising them. The management of funds includes the appropriate recording of gifts, the monitoring of cash versus pledges, and decisions about using particular gifts. The cost of raising funds must be closely watched and accurately reported to ensure its reasonableness and conformity to industry standards.

Tax-exempt status

While more than 20 categories of tax exemption are provided for by the IRS, most higher education institutions derive their tax exemptions from Section 501(c)(3) — charitable, educational, religious or scientific institutions.

Each institution is subject to rules that control the types of activities it can carry on within its particular tax-exempt classification. The extent to which the IRC allows lobbying, for instance, varies among the tax-exempt classifications. Lobbying — attempting to influence legislation — is allowed for a 501(c)(3) institution but is limited to an "insubstantial amount" of its activities. A 501(c)(3) institution may, however, make an election under Section 501(h) of the IRC to quantify the amount it spends on grassroots lobbying — educating the public about certain legislation and its potential effects. Testifying before legislative committees is allowed; payments to legislators and contributions to political campaigns are not allowed.

As part of good fiscal stewardship, a trustee of a higher education institution must understand the purpose of the institution's tax exemption and what types of activities would jeopardize that status. The tax exemption itself is one of the institution's most important assets, and losing it would be devastating.

Political activities, as opposed to legislative activities, pose problems for higher education institutions. For example, 501(c)(3) institutions are strictly prohibited from using funds to attempt to influence the election of a candidate for office. Any use of funds for such a purpose is grounds for revocation of a 501(c)(3) institution's tax exemption. Other institutions remain exempt but are subject to excise tax if they spend money for political purposes. Since neither result is desirable, trustees must monitor an institution's political activities and policies carefully.
Private inurement can also lead the IRS to revoke an institution's tax-exempt status. Private inurement results when

an institution's assets or earnings are used for the benefit of an individual as opposed to the institution itself. For example, private inurement may result if an institution compensates a vendor, contractor or third party at a level that is unreasonably high compared with the level of effort and responsibility of the recipient. Trustees must monitor the activities of the institution and its officers to ensure no private inurement occurs.

Full disclosure

The public has a large stake in the operations of the higher education sector. Various tax exemptions granted to higher education institutions — such as property tax exemptions and sales tax exclusions — represent billions of dollars in lost tax revenue. Deductions of donations to 501(c)(3) institutions disclosed in personal income tax filings alone account for billions more in lost tax dollars each year.

In exchange for these benefits, higher education institutions are expected to provide full financial disclosure, implement efficient management practices and engage in ethical behavior.

To obtain the detailed information they're looking for, many potential contributors and other stakeholders examine an institution's Form 990 filings. The IRS and institutions themselves are required to make copies of these informational returns available to anyone who asks for them.

In addition to making Form 990 filings available, boards should consider posting clear and concise financial narratives, charts and other disclosures on the institution's website.

Operating procedures

Once the board is well-educated, well-rounded and kept informed of its duties, responsibilities and liabilities, what's next? To effectively oversee the institution's operations, boards should employ a number of strategies and procedures.

Committees

Boards generally appoint committees to focus on particular areas of responsibility. Committees are essentially subsets of the full board. Specialists in one or two issues can examine them in detail during committee meetings — thus minimizing the time the full board must devote to those issues and maximizing the effectiveness of meetings of the full board.

Some committees typically focus on the institution's purpose, programs and mission. Other committees are more general in nature — governance, finance, audit, investment, executive, development/fundraising, HR/compensation and nominating.

Boards should guard against appointing too many standing committees. Sometimes an issue arises for which a task force or an ad hoc committee may be more appropriate than a standing committee. A task force or an ad hoc committee is similar to a standing committee, except that it is not a permanent appointment. After it recommends a solution to a problem or completes its project, the group disbands.

All trustees should serve on one or more board committees based on their skills and talents. A new trustee should come prepared with an idea of which committee he/she would most like to join.

Information flow to board members

If the board is to have a significant role in governing the institution, and if trustees are to minimize their exposure to legal liability, it is crucial that information about the institution's affairs is available to them.

Trustees should ask themselves several questions:

- Is the information adequate without being overwhelming?
- Is it available when needed?
- Are the special needs of the board considered?
- Above all, is the information accurate?

An effective communication system has several components:

- An advance schedule of board and committee meetings.
- A specific agenda for each meeting.
- Advance distribution of as much material as possible Preferably, material should be provided to each trustee at least one week before the meeting.
- A standard report package for each board meeting. Periodic, timely mailings by the president of key letters, memos, releases, industry reports and presentations. Topics should include budgets, profit plans, the institution's long-range plan, significant policies and procedures, and committee reports.
- Meeting minutes, all of which should be reviewed for accuracy.
- Technology enablement (e.g., a repository where electronic versions of board and meeting materials are available, forums for conversation exchange).

Obviously, much of the information a prudent board requires is of a financial or operational nature — current operating results, comparisons of actual results to budget, a statement of financial position and the president's or CFO's report. Quarterly projections are useful for helping trustees anticipate problems and evaluate actual performance. Trustees may also benefit from a review of cash and working capital forecasts, capital expenditure plans, employee pension plan information, and of course, academic and administrative achievements, along with data pertinent to specific issues or concerns the institution faces.

Preparing for meetings

A trustee owes it to himself/herself, the other trustees and the institution to be thoroughly apprised of all issues. A trustee should be familiar with the information provided in advance of a board or committee meeting. The amount of preparation time will vary from board to board, depending on the nature of the institution and the issues it faces. Spending one hour in preparation for each hour of the board meeting is a good rule of thumb. A trustee should arrive at board or committee meetings prepared to ask intelligent, probing questions and to take initiative in dealing with the institution's issues. A trustee should always keep in mind that he/she will be held legally accountable for actions or inactions.

If after reviewing the materials in the information packet a trustee has additional questions or needs further clarification, he/she should contact the board chair or committee chair and discuss any concerns before the meeting. The board chair or committee chair can then be prepared if further discussion at the meeting is warranted.

Building a better board

Evaluations of each trustee should cover such subjects as attendance at board and committee meetings, participation in board discussions, constructive criticisms and suggestions, preparedness for meetings, and availability to the president.

If evaluations reveal underperformance, the board chair is responsible for discussing the matter with the trustee and giving that person the choice between improving his/her performance or resigning. If that conversation does not produce the desired results, the underperforming trustee's name should be withheld from the list of candidates for renomination.

Trustees also need to assess whether committee chairs are properly and effectively leading the committee and helping the institution meet its goals.

To form an effective board, trustees must have a clear understanding of the strengths and weaknesses of the overall institution, its mission and what it seeks to accomplish. Such an understanding can be gained through a comprehensive review of the institution and its people.

Criteria and selection

Trustees may have diverse backgrounds and come from varying socioeconomic levels. They frequently hold full-time managerial positions in the for-profit sector and bring to the board skills developed there.

But no matter their individual backgrounds, those on the board should collectively possess a number of critical traits, many of which are obvious — honesty, good judgment, common sense, perspective, conscientiousness, independence, intelligence, objectivity, the willingness to take positions and to question, and the courage to act. Trustees must also have good people skills. They must be able to evaluate people and their performance accurately, and, at the same time, they must get along well with others.

Overall management expertise is important. Trustees should be able to understand and interpret financial and operating reports, and help management form institutional policies, plans and objectives. Good trustees should be willing to learn about the institution and develop familiarity with the sector and marketplace in which the institution operates. In addition, trustees should be familiar with the federal, state and local laws that affect the institution.

A specific profile for the type of individual and specific expertise required to round out the board should be based on the nominating committee's understanding of the issues the board and the institution are expected to face.

Trustees should also be aware of their public and social responsibilities. Their actions and behavior should enhance the institution's reputation — and should certainly not detract from it.

It is rare to find all of those traits and qualifications in any one trustee, but the board as a whole should possess them. A prudent board screens for critical attributes, just as management vets and interviews prospective employees. Candidates should be interviewed by several trustees, including the chair:

Potential trustees should be asked several key questions:

- Are they qualified and willing to serve?
- Will they be able to give the time and financial commitment necessary to complete the task?
- Are they able and willing to support the institution's fundraising?
- Will their appointment and performance reflect well on the institution and its mission?

Before selecting new members, a board should obtain:

- Biographical data concerning all candidates
- Candidate references provided by individuals not affiliated with the institution
- Signed conflict-of-interest statements and disclosures of any potential conflicts of interest
- A background check to verify that no criminal, financial or ethical issues exist that could harm the institution's reputation

After a candidate has been approved, it is in the best interests of the institution to orient the new trustee quickly to his/her role. The quicker the orientation, the more productive the trustee will be and the more valuable the trustee's relationship will be to others at the table.

The trustee's role: A recap

Demands on the trustees of higher education institutions continue to mount. Meeting these expectations requires the investment of time, money and expertise; dedication to shaping the direction of the institution; and commitment to protecting the interests of the people who support it and are served by it.

It is the expertise and contributions of the board that can make the difference in helping higher education institutions overcome financial or operational difficulties. And when an institution thrives, its trustees can see the tangible benefits of their efforts toward successful achievement of the institutional mission.

Did you find this content useful?

Click on an icon to provide your feedback

About Grant Thornton LLP's services to higher education

More than 700 dedicated industry professionals serve the audit, tax and advisory needs of over 200 public and private higher education institutions — community colleges, liberal arts colleges, universities, research institutions, academic medical centers, graduate schools and multicampus state systems. Grant Thornton's Higher Education practice has a well-earned reputation for providing clients with in-depth knowledge and a unique understanding of the higher education sector and its operations, opportunities and challenges.

Higher education is a strategic industry segment for our firm. Our commitment to this sector is reflected in our active participation and leadership in, and sponsorship of, key industry associations and conferences. As a leader in this sector, we are also dedicated to giving back to the higher education community by sharing our best-practice experience through myriad thought leadership we produce via articles, webcasts and training.

Our clients rely on us, and we respond to that trust by making continuous investments in our people so we can provide our college and university clients with the highest level of service. We are the only leading accounting firm to have fully dedicated professionals from staff to partner who work exclusively with our higher education and not-for-profit clients. Our higher education professionals provide our clients with information about relevant industry trends, and accounting and regulatory pronouncements; practical insights and value-added recommendations; personal attention with timely, authoritative feedback and quick responses; and high-quality service with measurable results.

Keeping you informed about industry trends

We are committed to helping you stay up-to-date on industry developments. Contact one of our professionals, or visit gt.com/highereducation for educational forums, articles, webcasts and nationwide speaking engagements on current issues of interest to higher education leaders.

Here are some of the ways we serve the not-for-profit sector:

Dennis Morrone
National Managing Partner
Not-for-Profit & Higher
Education Practices
T +1 631 577 1852
E dennis.morrone@us.gt.com

Audit Services

Jennifer Hoffman
Audit Services Leader
Not-for-Profit &
Higher Education Practices
T +1 631 577 1852
E jennifer.hoffman@us.gt.com

- Financial statement audits
- Benefit plan audits
- Agreed-upon procedures
- Uniform guidance audits

Tax Services

Daniel Romano
Tax Services Leader
Not-for-Profit & Higher
Education Practices
T +1 212 542 9609
E daniel.romano@us.gt.com

- Forms 990, 990-PF and 990-T filing positions
- International operations and investment reporting
- Unrelated business income and tax minimization
- State and local tax matters
- Employment and payroll tax compliance

Advisory Services

Matt Unterman
Advisory Services Leader
Not-for-Profit & Higher
Education Practices
T +1 212 542 9834
E matt.unterman@us.gt.com

- Strategy and governance
- Operations improvement
- Information technology
- Risk services
- Compensation and benefits
- Turnaround and restructuring
- Forensic and valuation
- Transaction support

Connect with us

grantthornton.com
@grantthorntonus
linkd.in/grantthorntonus

Tax professional standards statement

This content supports Grant Thornton LLP's marketing of professional services and is not written tax advice directed at the particular facts and circumstances of any person. If you are interested in the topics presented herein, we encourage you to contact us or an independent tax professional to discuss their potential application to your particular situation. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this content may be considered to contain written tax advice, any written advice contained in, forwarded with or attached to this content is not intended by Grant Thornton LLP to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.

Grant Thornton

GT.COM