Board Member Independence

We often define individual independence as freedom from outside control or influence by others around us or having the confidence to act according to our own will.

We can refer to the same definitions when we look at the independence of our organization's board of directors or the individual board members composing the governing team, though it is not always straightforward. The lack of board independence may result from structure or members' mindsets.

Duty of loyalty

A key legal obligation of a board member is a duty of loyalty. The object of this loyalty is the nonprofit organization each board member is helping to govern. Board members have a duty to place the interest of their nonprofit before anything else when acting in their fiduciary capacity. This undivided loyalty means objectivity in decision making, an unbiased approach to issues, freedom from ulterior motives or external control, and an absence of conflict of interest when choosing between options. Ultimately the full board as a body must act in an independent manner in its decision making.

Form 990 definition

The IRS Form 990 defines independence in the strict sense of being employed or being compensated by the organization. For a board member to be considered independent in the eyes of the IRS, the following three conditions must be met:

- No compensation as an officer or employee of the organization or a related organization. Most often this refers to a board member serving a dual function as a board member and a staff member.
- No (or less than $10,000) compensation as a contractor to the organization or a related organization. Reimbursement of expenses is not included in this calculation.
- No other financial transactions directly to the organization or a related organization or to a family member from the organization or a related organization. This includes loans, grants, and other similar payments.

State regulations

Most state laws require a board member to be a natural person, not necessarily a resident of the state, and allow the bylaws and articles to further define the qualifications. For numerous years, a few states — Maine, Vermont, and North Dakota, for instance — have required that no more than 49 percent of the individuals serving on the board of any public-benefit corporation may be financially interested individuals, defining "financially interested" as receiving compensation for personal services rendered to the corporation within the previous 12 months. These states include spouses and close family members within this definition. New Hampshire further prevents an employee of a charitable nonprofit corporation from holding the position of chairperson or presiding officer of the board. California, in 2004, revised its statutes and applies the 49 percent rule to interested individuals.

We may, in fact, be witnessing a new trend. With a lot of publicity, New York revised its laws (effective July 1, 2014) and carefully addressed independence as a key characteristic of an accountable board. The law applies to any organization doing business in New York and states that a board member

- may not have been an employee of, or does not have a relative who was a key employee of, the corporation or an affiliate of the corporation in the past three years
- has not received $10,000 or more in direct compensation from the corporation or an affiliate in the past three years (other than expense reimbursement or reasonable compensation as a director)
- is not a current employee of or does not have substantial financial interest in an entity that made or received payments from the corporation or an affiliate of more than $25,000 or two percent of the corporation's gross revenue (whichever is less) in the past three years (excluding charitable payments)
- does not have a relative who is a current officer of or has a substantial interest in an entity making or receiving payments of a similar amount to the organization in the past three years.

Independence and conflict of interest

There is a close link between a conflict of interest and a lack of independence — however, only facts and circumstances can prove the case. Conflict of interest can be potential, actual, or perceived. All three require attention but may need different solutions. In a boardroom an actual conflict of interest takes place when a board member allows ulterior motives to guide his opinion, such as a financial or personal interest in the transaction. The board member is influenced by outside factors and thus not acting in a fully independent manner.

Independent-mindedness

Genuine independence assumes that a board member has a presence of mind to make a decision that derives from the obligation and need to help the organization. At the same time, it is possible to have more than one beneficiary for a decision — the board member himself may reap some incidental benefits but, during independent decision making, his or her objectives and priorities must be clear.

A board member demonstrates independent-mindedness by candor and thorough reflection, asking questions until all sides of an issue have been aired, daring to contradict or question present practices or traditions, and not being influenced by seniority, position, or reputation of a fellow board or staff member or a donor. In short, a thorough deliberation allows a board member to learn all the facets of an issue and then to distill his or her peers' perspectives into an autonomous and educated opinion.

Structural lack of independence

Independence in the boardroom primarily refers to behavior, and although the definition cannot be limited to a position, status, or relationship, these qualifiers may indicate a potential lack of independence. Certain situations tend to be so loaded with potential conflicts of interest — and therefore potential lack of independence — that it is fair to avoid them.

The following are some situations that normally prevent an individual from being fully independent as a board member:

- Serving as the chief executive and the chair of the organization at the same time
- Serving as a voting board member while functioning as a paid staff member
- Serving as a board member while a spouse or close relative acts as the chief executive

The following situations prevent an individual from being fully independent or disinterested vis-à-vis a specific decision:

- Serving on the governance committee that presents the slate for officers and running for an officer position
- Remaining in a decision-making position that leads to self-dealing, i.e., the board member ends up on both sides of a financial transaction

Tools to ensure independence

To ensure independence, a board has a set of options that eliminates clear obstacles, provides means to handle tricky situations, and, above all, encourages a culture of inquisitiveness.

Conflict-of-interest policy

A solid conflict-of-interest policy and its unequivocal enforcement provide a guide for behavior and a method of managing conflicting situations. Full disclosure of potential dualities of interest by board members demonstrates voluntary compliance. Recusal from participation in discussions and decision making where a conflict is present leaves decisions in the hands of disinterested board members. The policy should also address contemporaneous recording of the recusal in the minutes and handling of situations when independence is questioned.

Role clarification

When board members understand their individual and shared responsibilities and liabilities, they position themselves as governors of the organization. Independence is understood at the personal level and as a collective objective. This understanding helps create the necessary tie between board decisions and the future success of the organization. A periodic review of qualifications and independence of board members reinforces role definitions and overall desirable characteristics in team members.

Processes

Negotiations at arm's length, standard bidding for vendor selection, and regular executive sessions for boards without staff present support neutral decision making. In addition, predetermined definitions of situations that endanger board member independence (professional, financial, social, familial) form a framework for red flags.

Culture

With structural and policy guidelines defined and in place, the board has a support system to meet its compliance expectations. Now it needs to concentrate on developing a culture featuring a mind-set that taps into board members' know-how, individuality, and intellectual richness. Past and present contacts and experience turn into an asset rather than a source for conflict. The board relies on its collective wisdom by encouraging open discussion and debate.

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