

# Charity Regulators: Focus on Enforcement of Corporate Policies

06.28.17 | Linda J. Rosenthal, JD



“When government regulators meet,” we wrote in a [recent post](#), “they make lists of the most pressing topics that keep them up at night.” One such list is a March 2017 [article](#) in The Nonprofit Times. There, the authors discussed five hot-topic areas that give regulators apoplectic fits these days:

- Governance & Compliance: Policy vs. Practice
- Scrutiny of Fundraising and Overhead Costs
- Solicitation and Use of Donor-Restricted Gifts
- Online Fundraising & Technology
- New Legal Structures for Achieving Social Impact

We started our discussion of these points by jumping right into the fourth topic; see “[Issues in Online Giving](#).”

Now, we turn back to the beginning: governance and compliance. “One of the longstanding legal problems that nonprofits continue to face is failure by boards to [properly implement](#) adopted governance and compliance policies.”

## *Governance Focus of Oversight Activities*

Governance has *always* been important in terms of oversight priorities, but federal and state regulators [dramatically stepped up interest](#) and scrutiny in the wake of the massive corporate scandals a decade and a half ago. Officials sprang into action, [enacting a law](#) commonly known as [Sarbanes-Oxley \(“SOX”\)](#).

It had tough new rules and controls, as well as criminal penalties; the law was written “to [prevent wrongdoing](#) and enhance both the integrity of financial reporting and the quality of corporate

governance.”

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*Although aimed primarily at publicly traded, for-profit corporations, a few of the SOX requirements also directly apply to nonprofits: ‘They must have a system for accepting and dealing with whistleblower concerns; they must have policies that protect against the intentional destruction of key documents, and their employees must not impede or obstruct governmental investigations.’*

This federal activity “launched some big changes in government oversight of charities, including – notably – the complete overhaul of the IRS Form 900, effective 2008. In newly added Part VI, “Governance, Management, and Disclosure” the agency “...probes how a nonprofit manages critical issues such as the independence of the board and the resolution of conflicts of interest among key players in the organization.”

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*The Internal Revenue Service believes that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests more than one with poor or lax governance.... [W]hile the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful . . . [about] governance practices.... As a measure of our interest in this area, we ask about an organization’s governance, both when it applies for tax-exempt status and then annually as part of the information return that many charities are required to file.*

See our discussions in earlier posts including “Written Governance Policies: Which Ones Should Nonprofits Have?”

As a result of these corporate scandals, states acted as well. Sarbanes-Oxley –

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*was the model for the California Nonprofit Integrity Act and similar laws and regulations by other jurisdictions focusing on the accuracy and transparency of financial statements and other reporting by nonprofit organizations. It was also a key factor in the move by think tanks and leading agencies within the philanthropy community like Independent Sector to develop “best practices” standards for nonprofits. (These organizations consulted and cooperated with federal officials in developing the revised Form 990.)*

### *Enforcement of Policies is Key*

More recently, this focus has switched from an emphasis on *drafting* corporate policies on good governance to actual enforcement of those written policies.

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*One of the ... legal problems that nonprofits continue to face is failure by boards to properly implement adopted governance and compliance policies. For example, with respect to conflicts of interest, is the board properly considering alternatives when a proposed financial transaction will benefit an insider? Are only the independent directors reviewing and approving such transactions based on the best interests of the organization?*

“To ensure effective governance and compliance, nonprofit boards should regularly review their policies in light of applicable laws and best practices, but also take time to ensure that they are being properly implemented.”

### *Conclusion*

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*Boards that treat governance as a mere rubber stamp of the executive staff's decisions do not provide the checks and balances that are critical to their function as fiduciaries of the organization.*

What happens if these policies are not observed and implemented? There may be serious trouble with regulators as well as serious consequences including possible penalties and other sanctions,

including – at the most extreme – loss of tax-exempt status.