NONPROFITS: BOARD GOVERNANCE

# It's a New Year - Take a Look at Your Governance Policies

02.14.17 | Linda J. Rosenthal, JD


Starting fresh each January 1st, most of us adopt the same New Year's resolutions that we had abandoned – unfulfilled – the year before. As we've posted previously, the "clean slate" concept so appealing to individuals is a serious and critical aspect of prudent organizational management. At least once a year, each nonprofit – large or small – should conduct a formal evaluation and review of its practices, systems, and operations.

Any annual checklist should include a review (and possible revision) of the organization's written governance policies as well as consideration of which additional ones should be drafted and adopted.

## *Which Governance Policies Are Needed?*

The Internal Revenue Service "'encourages a charity's board of directors to adopt' specific written policies" on a variety of matters including executive compensation, fundraising, investments, document retention, and conflict of interest.

We've previously explained that this governmental advice about adopting written governance policies is …" *not* mandatory. Think of them as . . . suggestions; kind advice that a nonprofit can't exactly refuse."

> *The current '...IRS approach to governance' is '...not requirements, exactly, so much as questions ....' But questions asked by the IRS are not ordinary questions, and the understandable desire of nonprofits to 'give the right answer' inevitably drives behavior. There's also a greater chance of being audited, if an organization fails to adopt any of these policies that have been 'recommended ... for consideration.'*

The IRS' interest is governance is relatively new – mostly in the last decade. The agency – 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…. Agency representatives "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.

This significant interest in governance practices, transparency, and accountability arose from the huge corporate scandals – including Enron, for instance – in the early 2000's. Tough new laws were passed, aimed primarily at publicly traded, for-profit, companies, but there has been a ripple effect reaching more broadly in the economy, including to the nonprofit sector. Indeed, the key legislation, commonly known as Sarbanes-Oxley ("SOX"), has a few rules that apply across the board including 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."

The complete overhaul of the IRS Form 990 in 2008 reflected this new governance focus. "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.'

We published a series of posts titled "When the Revenue Agent Comes Calling," based on the Form 14114, Agent Audit Checklist, developed after 2008, which IRS agents use in connection with examinations of nonprofits. There are specific questions about various governance policies. See here for the introductory post, and here (conflict of interest policy); here (document retention policy); and here, (compensation policy).

In addition to heightened interest by the Internal Revenue Service, many states also took action following the corporate scandals.:

> *Sarbanes-Oxley 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.)*

## *Samples and Resources*

Subject to the important caveat that each nonprofit should have custom governance policies crafted for it, there are good resources online for ideas and sample language. A particularly useful source is Public Counsel's Form 990 Policy Series.

Public Counsel is a huge pro bono law firm that works "with major law firms and corporations to change people's futures. It is the "public interest law firm of the Los Angeles County and Beverly Hills Bar Associations as well as the Southern California affiliate of the Lawyers' Committee for Civil Rights Under Law."

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Public Counsel's Form 990 Policy Series was developed as a result of the overhaul of the federal Form 990 in 2008, and the new focus on written governance policies.

*The resulting Form 990 Policy Series Memoranda include form policies, with a discussion of why various provisions might be used by a particular type or size of organization. Equally importantly, the Memoranda include rationales for adoption of the policies, including references to applicable statutes and regulations, and procedures for legal counsel to use in advising their clients on drafting and adopting such policies.*

This Series includes the following governance policy topics:

- Compensation
- Conflict of Interest

- Conservation Easements
- Document Retention and Destruction
- Form 990 Review
- Fundraising
- Gift Acceptance
- Independent Governing Body
- Investment
- Joint Ventures
- Mission Statement
- Public Disclosure
- Whistleblower

There are plans for additional topics including: “Endowments; Consistent Operation of Chapters/Affiliates/Branches; and Financial Statements/Audit Policy.”

## *Conclusion*

Unlike your own fleeting New Year’s Resolutions to lose weight or call your mother more often, these plans for your organization’s long-term well-being should be a serious, no-nonsense, commitment that is honored each year.