

Written Governance Policies: Which Ones Should Nonprofits Have?

07.30.15 | Linda J. Rosenthal, JD



"I'm gonna make him an offer he can't refuse."

– Mario Puzo –*The Godfather*

The Internal Revenue Service “encourages a charity’s board of directors to adopt” specific written policies on matters including executive compensation, fundraising, and investments.

The agency also advises organizations to put together at least a simple whistleblower policy, and to whip up some handy procedures about which documents to keep or destroy, and for how long. There’s even a [sample conflict of interest policy](#) in the instructions for Form 1023.

These are not requirements, though – the IRS adds helpfully in a tone vaguely reminiscent of Don Corleone. They’re not mandatory. Nonprofits should think of them instead as . . . suggestions; as kind advice from your friendly tax agency that a nonprofit ... “can’t exactly refuse.” Nonprofits should view the current “[...IRS approach to governance](#)” more “as questions” than “requirements....”

IRS and Written Policies

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 stated rationale for the Internal Revenue Service to request information about an organization’s written policies on governance is that 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.... 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.”

The Push for Accountability

This laser-like focus on governance practices, transparency, and accountability is relatively new. The catalyst for this activity: the Enron, Worldcom, and other corporate scandals that exploded across the headlines in the early 2000s.

Government officials sprang into action, enacting a law commonly known as Sarbanes-Oxley (“SOX”); it bears the names of the sponsoring legislators

These were tough new rules and controls; there were criminal penalties as well; the law was written “to prevent wrongdoing and enhance both the integrity of financial reporting and the quality of corporate governance.”

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 important federal legislation launched some big changes in government oversight of charities including – notably – the complete overhaul of the IRS Form 990, 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.”

States acted as well after the huge corporate-corruption 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. These problems also spurred 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.)

These aren’t the only ways, though, that Sarbanes-Oxley has affected nonprofits: “The entire relationship between nonprofits and their auditors has changed, as have the independence and responsibilities of board audit committees.” Now, “few nonprofits allow the cozy relationships that once existed between board members and the accounting consultants who review and approve financial statements, tax returns, and other documents. Many nonprofits have also adopted Sarbanes-Oxley-style ethics guidelines for their financial officers.”

In addition to the written governance policies already mentioned, charities may also want to consider adopting policies about gift acceptance, employment matters, social media, and volunteers. For organizations with group tax exemptions, policies governing chapters or affiliates are a good idea.

Conclusion

In future posts, we'll take a more in-depth look at certain of these policy document suggestions.

— *Linda J. Rosenthal, J.D., FPLG Information & Research Director*